National Library
of Canada

Canadian Theses Service

Ottawa, Canada
K1A 0N4

Bibliothèque nationale
du Canada

Service des thèses canadiennes

NOTICE

The quality of this microform is heavily dependent upon the quality of the original thesis submitted for microfilming. Every effort has been made to ensure the highest quality of reproduction possible.

If pages are missing, contact the university which granted the degree.

Some pages may have indistinct print especially if the original pages were typed with a poor typewriter ribbon or if the university sent us an inferior photocopy.

Reproduction in full or in part of this microform is governed by the Canadian Copyright Act, R.S.C. 1970, c. C-30, and subsequent amendments.

AVIS

La qualité de cette microforme dépend grandement de la qualité de la thèse soumise au microfilmage. Nous avons tout fait pour assurer une qualité supérieure de reproduction.

S'il manque des pages, veuillez communiquer avec l'université qui a conféré le grade.

La qualité d'impression de certaines pages peut laisser à désirer, surtout si les pages originales ont été dactylographiées à l'aide d'un ruban usé ou si l'université nous a fait parvenir une photocopie de qualité inférieure.

La reproduction, même partielle, de cette microforme est soumise à la Loi canadienne sur le droit d'auteur, SRC 1970, c. C-30, et ses amendements subséquents.

NL-339 (r. 88/04) c

Canada

UNIVERSITY OF ALBERTA

THE RIGHTS, INTERESTS AND DUTIES OF HOST COUNTRIES AND INTERNATIONAL OIL COMPANIES UNDER INTERNATIONAL PETROLEUM AGREEMENTS

BY

FRANCIS KOFI ABIEW

A thesis submitted to the Faculty of Graduate Studies and Research in partial fulfilment of the requirements for the degree of MASTER OF LAWS.

FACULTY OF LAW
Edmonton, Alberta
FALL 1991

National Library
of Canada

Bibliothèque nationale
du Canada

Canadian Theses Service

Service des thèses canadiennes

Ottawa, Canada
K1A 0N4

The author has granted an irrevocable non-exclusive licence allowing the National Library of Canada to reproduce, loan, distribute or sell copies of his/her thesis by any means and in any form or format, making this thesis available to interested persons.

The author retains ownership of the copyright in his/her thesis. Neither the thesis nor substantial extracts from it may be printed or otherwise reproduced without his/her permission.

L'auteur a accordé une licence irrévocable et non exclusive permettant à la Bibliothèque nationale du Canada de reproduire, prêter, distribuer ou vendre des copies de sa thèse de quelque manière et sous quelque forme que ce soit pour mettre des exemplaires de cette thèse à la disposition des personnes intéressées.

L'auteur conserve la propriété du droit d'auteur qui protège sa thèse. Ni la thèse ni des extraits substantiels de celle-ci ne doivent être imprimés ou autrement reproduits sans son autorisation.

ISBN 0-315-70291-5

Canadä

UNIVERSITY OF ALBERTA

RELEASE FORM

NAME OF AUTHOR: **Francis Kofi Abiew**

TITLE OF THESIS: **The Rights, Interests and Duties of Host Countries and International Oil Companies Under International Petroleum Agreements**

DEGREE: **Master of Laws**

YEAR THIS DEGREE GRANTED: **Fall, 1991**

Permission is hereby granted to the University of Alberta Library to reproduce single copies of this thesis and to lend or sell such copies for private, scholarly or scientific research purposes only.

The author reserves all other publication and other rights in association with the copyright in the thesis, and except as hereinbefore provided neither the thesis nor any substantial portion thereof may be printed or otherwise reproduced in any material form whatever without the author's prior written permission.

....

Francis Kofi Abiew
c/o Mr. K.S. Dza
P.O. Box 12604
Accra-North
Ghana.

September 30, 1991

THE UNIVERSITY OF ALBERTA

FACULTY OF GRADUATE STUDIES AND RESEARCH

The undersigned certify that they have read, and recommend to the Faculty of Graduate Studies and Research for acceptance, a thesis entitled "The rights interests and duties of host countries and international oil companies under international petroleum agreements" submitted by Francis Kofi Abiew in partial fulfilment of the requirements for the degree of Master of Laws.

D. R. Percy
Professor David R. Percy

Linda Reif
Professor Linda Reif

Fred Judson
Professor Fred Judson

Date 19/9 1991

ABSTRACT

The legal regime governing international petroleum agreements between host countries, particularly developing countries, and international oil companies often creates a kind of imbalance where the former feel they have been ill-used, even cheated. This state of affairs persists and is often attributable to the weaker bargaining position of the host countries, which arises from a number of factors including the lack of capital and technical expertise necessary to deal at arms length with international oil companies in the development of their resources.

It is the primary aim of this thesis to examine the broad legal relationship or framework that characterises most of these agreements and to offer suggestions capable of yielding mutual benefits to the parties.

Chapter I provides a historical sketch of international oil companies and their operations in developing countries. The early concessions and the emergence of OPEC are dealt with to give an understanding of the major developments that have taken place in the world oil scene.

Chapter II offers a brief focus on the interests of host countries vis-a-vis international oil companies as well as the constraints involved in structuring a mutually advantageous petroleum contract.

Chapter III is devoted to a discussion of the institutional and legislative mechanisms set in place in host countries to bring about the desired changes against the background of the host countries' permanent sovereignty over their natural resources.

Chapter IV evaluates the trends in the main types of petroleum contracts between the parties by using examples from actual contracts concluded. The conclusion is reached that the distinctions between the main contractual types are helpful conceptually and that paying attention to the terms of the contract will yield mutually beneficial results.

Chapter V discusses differing approaches to dealing with changing circumstances under the petroleum agreement. Clauses such as stabilization, force majeure, hardship, and choice of law are considered.

Chapter VI concludes this study by addressing the most important issues that require action in structuring a stable and equitable petroleum regime.

ACKNOWLEDGEMENT

My thanks primarily go to my supervisor Professor David Percy, for making this modest attempt a reality and for exposing my mistakes both in thought and style.

I would like to express my gratitude to Professors Linda Reif and Fred Judson of the Department of Political Science for consenting to serve on my examining committee.

I am most grateful to the staff of the John A. Weir Law Library for their assistance in obtaining relevant material needed for this work.

I am greatly indebted to Lillian and Lorne MaePherson, Professor Fred Decoste, Anne Mclellan, Dr.Khetarpal, Mike Storozuk, Sandra Wilkins, Kiran Gurung, Shannon O'Byrne and Charlene Playfair for their kindness and constant encouragement in various ways.

Finally, I wish to render my sincere thanks to my colleagues and friends too numerous to mention here, without whose help this work would not have been completed.

Table of Contents

Chapter 1

1. Introduction 1

Chapter 2

1. Introduction 25

2. Objectives of Host Governments 26

2.1. Constraints on the development of a good petroleum arrangement on the part of Host Countries 28

3. International Oil Company Objectives 30

Chapter 3

1. Introduction 38

2. The principle of permanent sovereignty over natural resources 39

  a. Historical background and development of the concept in the United Nations General Assembly 39

  b. Origin and development of the concept of permanent sovereignty over natural resources 43

3. Institutional framework 52

  a. National Oil Companies in developing countries 52

    i. Form 54

    ii. Objectives and Powers 56

    iii. Structure and Administration 58

    iv. Accountability and Control 60

    v. Judicial Control 63

vi. Role of national oil companies in developing countries 67
4. Legislative Framework........ 71

Chapter 4

1. Introduction........ 80
2. Concession Agreements........ 81
2.1. The Original Concession........ 81
a. An assessment........ 85
2.2. The Modern Concession........ 86
a. An assessment........ 102
3. Production-Sharing Agreements........ 103
a. An assessment........ 114
4. Risk Service Contracts........ 117
4.1. Mechanism used for reimbursement of the International Oil Company........ 122
a. An assessment........ 126
5. Participation Agreements........ 129
5.1. An assessment........ 136
6. Concluding Remarks........ 137

Chapter 5

1. Introduction........ 142
2. The legal nature of International Petroleum Agreements........ 143
3.1. Stabilization provisions 153
3.2. Force majeure provisions........ 159

3.3. Hardship provisions.. 165

3.4. Governing Law provisions.. 167

- a. Public International Law.. 169
- b. General Principles of Law.. 170
- c. Transnational Law.. 173
- d. Lex Contractus.. 174
- e. Municipal Law.. 174

4. Concluding Remarks.. 177

Chapter 6

Conclusions.. 180

Bibliography.. 187

CHAPTER ONE

THE EMERGENCE OF INTERNATIONAL OIL COMPANIES AND THEIR RELATIONSHIP WITH THE HOST COUNTRY; A CONSPECTUS.

1. Introduction:

Since the beginning of oil production when Col. Edwin Drake drilled his first oil well in Titusville in August 1859,[1] oil has become a valuable commodity.[2] The contribution of International Oil Companies (IOCs) in the development of the world's petroleum resources in recent years has been immense.

Several important changes have, however, taken place in the world oil industry since the beginning of this century that cannot be ignored in any attempt to examine whether the legal regime governing international petroleum agreements between host countries (HCs) and IOCs need to be changed. HCs have often felt that petroleum arrangements concluded with IOCs have been inequitable in so far as the benefits to be derived from the contracts are concerned. In attempting to devise arrangements that will benefit both parties, one needs to proceed from a basic understanding of the operations of the major actors on the world oil scene. It is also important to note the developments that have taken place in the industry over the years. The changes, if any, that have taken place must offer some general guidance for the future direction of structuring an equitable relationship between HCs and

---

[1] The existence of oil however dates back to Biblical times. For details see, Gupta R.N., Oil in the Modern World (Reprint edition 1976) at p.9; Rouhani F.A., A History of O.P.E.C. (1971) at pp. 35-36: Some controversy exists as to whether the first oil well was discovered in Canada or the United States, See Hossain K., Law and Policy in Petroleum Development (1979) at p.29.

[2] For details of events in the oil industry generally between the years 1859-1911, see Harvard Business School papers given at the seminar on the history of the petroleum industry, in Oil's First Century (1959); Clark S.J., The Oil Century (1958) at chaps.1,7.

IOCs.

This chapter thus presents a general overview of some pertinent developments in the international petroleum industry. A brief sketch of the structure and strategies of the IOCs is offered. This is intended to provide a basic understanding of the strategies of the companies over the years. Also, the early concession arrangements and the emergence of OPEC are dealt with. All these developments will provide the background understanding necessary for an appraisal of the legal regime governing international petroleum contracts. On the part of potential HCs which are now oil importers, for example, lessons from the OPEC countries' experience in their dealings with the IOCs and the realities of the present global energy situation should provide guide-posts for the planning of any meaningful oil development program.

The oil industry is composed of many different companies but three main categories of companies can be identified. There are, in oil industry terminology, firstly, the International Majors; secondly, the Independents and finally, the National Oil Companies. The International majors are sometimes referred to as the "Seven Sisters".[3] They are still considered to be amongst the largest oil companies even today. According to a U.S. Federal Energy Administration definition, the majors are those companies having a total refining capacity greater than 175,000 b/d and crude oil self-sufficiency greater than 30%.[4] The International Majors exhibit the following characteristics: 1)their operations are world-wide, 2)they employ nationals of many countries, and 3)they have (nationally) registered subsidiaries in many countries of the world.[5] They comprise Exxon Corporation, Mobil, Gulf Oil, Texaco and Chevron, which are American, Royal Dutch Shell, which is British and Dutch controlled, and lastly, British Petroleum, which is British controlled. Compagnie Française Des Petroles (CFP) is sometimes referred to as the eighth major for the simple fact that it participates in joint operations with the seven in parts of the Middle East.[6]

---

[3] This name is said to have been popularised by Enrico Mattei, see Sampson A., The Seven Sisters: The Great Oil Companies and the World they Shaped (1975) at p.59.

[4] This means the "majors" supply more than 30% of their refining capacity. See, Brossard E.B, Petroleum - Politics and Power (1983) at p.17.

The term "independent" is generally used to describe private companies which are smaller than the majors. They are sometimes described as "newcomers" or the "international minors".[7] According to one author, the independents are companies other than the seven majors without a global system of production, transport, refining and marketing.[8] However, today, one cannot be entirely correct in the assertion that the independents lack these global attributes for it would seem that at least some of them possess these characteristics, but perhaps they lack the sheer size developed by the majors. The independent group of companies such as Amoco, Phillips, Conoco, Amerada, Getty, Atlantic Richfield, Occidental etc., are all American firms which began operations within the United States. Also included in this group are some Japanese, Italian and European companies like Japan Petroleum Development Corporation, Elf and Agip. The third group of companies - the National or State Oil

---

[5] Odell P.,Oil and World Power (7th ed) (1983) at p.13.

[6] Stockholm International Peace Research Institute, Oil and Security (1974) at p.23.

[7] Tanzer M., The Political Economy of International Oil and the Underdeveloped Countries (1969) at p.31.

[8] Supra n.3, at p.143.

Companies, emerged as an important factor in the bid of host countries to assert control over their oil resources. Examples of these companies are Petróleos Mexicanos (Pemex), Ente Nazionale Idrocarburi (ENI) of Italy, National Iranian Oil Company (NIOC), Corporacio Venezolana del Petróleo, and Petro-Canada amongst others.[9] Such companies have been established in most oil-producing areas,(including for example the U.K.) with the notable exception of the U.S.A.[10]

As noted earlier, the major oil companies[11] pioneered the growth of the modern petroleum industry and their emergence was necessary to allow its integration.[12] For this purpose, therefore, according to Rouhani;

> "it was necessary to have very large amounts of capital available, so large that losses, which are often considerable, could be survived. It was necessary to create and maintain a powerful and diversified organization, and to place at its service specialized knowledge, skills, personnel, equipment, and materials. It was necessary, in the interests of multiplying sources of supply and spreading risks, to acquire exploitation rights in as many countries as possible and to gain a footing in all international markets."[13]

Thus, it could be observed that these characteristics pushed the "Majors" into a dominant position in the petroleum industry until just a few years ago. This ability to dominate, has, however, relatively declined due to, amongst other factors, the emergence of independent oil companies as well as state companies, coupled with the desire of host countries to free themselves from a foreign economic power structure.[14] In spite of these developments, however, it is still true to say that these large companies to a great extent continue to dominate the oil business as producers, and particularly as participants in the downstream operations of transporting, refining and marketing.[15] Moreover, their leading role is no longer entirely concentrated on oil since they have been investing in other energy sources, such as coal and nuclear energy, and are thus becoming general energy companies.[16] An important aspect of the structure of the majors has been extensive vertical integration of their upstream activities (i.e., exploration and crude-oil production) with the downstream part of the industry (refining and distribution). They are also extensively integrated horizontally at all levels across national boundaries.[17] Taken together as a group the seven majors owned and controlled in 1966 over three-quarters of crude oil production outside the United States and the socialist countries, 61 percent of refinery production and 70 percent of the tanker fleet.[18] In these same areas they still own or control over 70 percent of the total refining capacity and over 50 percent of the tonnage of internationally operating tankers;[19] the companies therefore are almost analogous to sovereign states in terms of the resources at their command.[20]

---

[9] Although the raison d'etres of ENI was to undertake overseas exploration programmes and to secure for Italy new sources of supply. Hossain K., supra n.1, at p.17.

[10] Cameron P.D., Property Rights and Sovereign Rights: The Case of North Sea Oil (1983) at p.29.

[11] [Hereinafter referred to as "Majors"]

[12] The term 'integration' when used with respect to corporate growth and development is defined as the process of extending the scope of activities which are under the ownership, management or control of a single company, and in the oil industry three general types of integration are distinguishable, viz; horizontal, vertical and product integration. For a detailed description of the process of integration in the oil industry, see Mclean J.G. & Haigh R.W., The Growth of Integrated Oil Companies (1954); Adelman M.A., The World Petroleum Market (1972) at pp.78-100.

[13] Rouhani F., supra n.1, at p.37.

---

[14] Sampson A.,supra n.3, at p.59.

[15] Ibid.

[16] Supra n.4.

[17] Penrose E.T., "The Structure of the International Oil Industry: Multinationals,Governments and OPEC" in Rees J. & Odell P,.eds., The International Oil Industry (1987) at p.13.

[18] Evan H.Z., "The Multinational Oil Company and the Nation State" (1970) 4 Journal of World Trade Law at pp.666-667.

By far the largest of the seven majors is Exxon (which is also known as Esso in parts of the world outside the U.S., but the name Exxon is gradually spreading worldwide).[21] Originally incorporated in 1882 as Standard Oil Company of New Jersey, it was established by John D. Rockefeller and built into a trust that controlled the world oil industry. Standard Oil was dissolved in 1911 by the U.S. Supreme Court ruling[22] that the company was a combination in violation of the Sherman Anti Trust Act of 1890. This resulted in the division of Standard Oil into thirty-four separate companies.[23] The strategies of Exxon, as successor of Standard Oil of New Jersey, over the years were concentrated in refining, gathering, storage, pipelines and rail transportation. Crude-oil production therefore, was not a priority area of operation in the formative years of the company. By 1924 the search for crude oil abroad was intensified as the company realized that its expanding markets necessitated the acquisition of its own means of supply as well as ensuring that oil reserves abroad did not become pre-empted by rival companies.[24] The company therefore, acquired massive crude reserves and production in the United States, Venezuela and the Middle East, overtaking Shell as the leading producer. Exxon's willingness to make massive commitments coupled with its well organised system of management and ability to respond to new challenges without changing strategy is very remarkable in the history of the oil industry.[25] Today, Exxon's change in strategy lies in the field of finding alternative energy sources, and it has invested in nuclear fuel fabrication and reprocessing, coal, coal gasification and uranium enrichment projects.[26]

---

[19] Odell P., supra n.5, at p.13.

[20] Cameron P.D., supra n.10, at p.22.

[21] It is also the World's largest petroleum company, operating in nearly 100 countries and owns, wholly or partly more than 500 subsidiaries. See, Financial Times Oil and Gas International Yearbook (1982) at pp.156-158.

[22] See, United States v. Standard Oil 221 U.S. (1910) 1.

[23] For details of the operations of the Standard Oil group before 1911, see, Mclean J.G. & Haig R.N., supra n.12, at pp.57-71.

[24] Penrose E.T., The Large International Firm in Developing Countries:The International Petroleum Industry (1968) at p.95.

The Royal Dutch Shell group (generally known by the trade name Shell) was formed in 1907 as a result of a joint venture between Royal Dutch Petroleum Company of the Netherlands and Shell Trading and Transport Company Limited, a British company. Like Exxon, it conducts operations at all stages of the industry and operates in almost all parts of the world; it is the second largest oil company in the world. Before the second world war, Shell was the largest producer, and the only major with worldwide production of crude.[27] After the war, it lost its expertise in finding oil and had to rely on its large scale world wide refining and marketing organization to move its purchased crude oil.[28] This situation has shaped the company's strategy of embarking on world-wide oil exploration. In recent years it has embarked on intensive projects to assist the development of countries in which it operates, and like the other companies is also pursuing a policy of diversification out of oil.

---

[25] For a detailed overview of the strategy of Exxon, see, Greene W.N., Strategies of the Major Oil Companies (1985) at pp.61-87.

[26] Id., at pp.82-83.

[27] Id., at p.228.

[28] Id., at p.209.

British Petroleum (BP), (formerly known as Anglo-Persian Oil company, and later on as Anglo-Iranian in 1935 until the adoption of its present name in 1954) was formed in 1909 to develop the petroleum resources of Persia (Iran) and was the pioneer of the Middle East oil industry. The company has been the most successful explorer for oil in the world but the weakest of the majors in the downstream activities of the industry.[29]

Gulf Oil Corporation, about the same size as BP, was formed in 1907. Its foreign operations began with exploration in Mexico which was its sole source of crude oil until 1925, and thereafter discoveries in Venezuela and Kuwait boosted its crude supplies greatly.[30] It identifies with upstream activities and has, with BP and Standard Oil of California, been most successful in exploring for new sources of crude oil.[31]

Chevron [formerly known as Standard Oil of California (Socal)], incorporated in 1926, was another offshoot of the Standard Oil Trust. Its activities cover exploration, transportation and the marketing of petroleum and their by-products. Chevron was a great explorer and was credited with discoveries in the United States, the Middle East (especially in Saudi Arabia) and the Far East. It is one of the less diversified of the majors and concentrates its efforts in the upstream activity of finding and developing resources.[32]

---

[29] Id., at p.237.

[30] Supra n.24, at p.117.

[31] For an in-depth discussion of Gulf Oil's strategy, see Green W.N, supra n.25, at pp.88-123.

The discovery of oil in Spindletop in East Texas gave birth to Texaco (originally known as the Texas Company) in 1901 and until 1967, their operations in the Eastern Hemisphere were associated with Standard Oil of California through the jointly owned Caltex.[33] Its policies and strategies were not therefore very different from Chevron. In recent years it has acquired a set of tactical objectives in five basic areas, namely 1)exploration for oil and gas, 2)modernisation of downstream facilities,3)continued petrochemical expansion 4)emphasis on alternate energy and 5)selective employment of assets in non-energy areas through internal programs.[34]

Mobil (another offshoot of the original Standard Oil Trust), its subsidiaries and affiliates, engage worldwide in all sectors of the petroleum industry. It was incorporated in 1882 as Standard Oil of New York and underwent several name changes. In 1931,it merged with Vacuum Oil and became known as Socony-Vacuum. Mobil is the smallest of the U.S International majors, and is primarily a marketer of petroleum products and weak in refining. Its policy over the years was to purchase crude from the most advantageous sources,[35] but in recent years it has placed emphasis on exploration and production. Its most recent strategic move has been diversification outside the oil industry.[36]

---

[32] Id., at pp.179-180.

[33] Supra n.24, at p.117.

[34] Supra n.21, at p.426.

[35] This policy which worked well in times of glut but poorly in times of shortage was to avoid expenditure on exploration without finding oil,taxation or nationalisation of resources, wells going dry and capital tied up in higher cost crude sources, see Greene W.N, supra n.25, at p.134.

One notable feature of the international oil companies which must be borne in mind is that although they demonstrate a pattern of similarity in the objectives and strategies of their global operations, individual differences shaped by their history and the environment in which they operate are discernible.

Perhaps in an attempt to predict the course of future relations between IOCs and host developing nations in their quest to develop their petroleum resources a brief historical account of IOC operations abroad will be appropriate.

The modern history of the involvement of IOCs in petroleum development in developing countries began with their entry into the Middle East with the grant of a concession by the Shah of Persia (Iran) to an Englishman named William Knox D'Arcy in 1901.[37] The broad features of the concession were, according to Longrigg:[38]

> "to find,exploit,and export petroleum.....granted for sixty years,to end on 28 May 1961.It covered the whole of Persia except(thanks to Russian influence) the five northern provinces;it conferred the exclusive right to build pipelines to the south coast;and it granted comprehensive customs and taxation exemption. The concessionaire

---

[36] For a summary of activities engaged in by the company, see Financial Times Oil and Gas International Yearbook, supra n.21, at pp.251-252.

[37] Longrigg S.H.,Oil in the Middle East; Its Discovery and Development(1968) at p.17. The first major concession, however prior to the D'arcy concession was the one granted to another British national, Baron Julius de Reuter in 1872 to exploit the mineral resources of Persia. This concession according to Lord Curzon;"When published to the world,it was found to contain the most complete and extraordinary surrender of the entire industrial resources of a kingdom into foreign hands that has probably ever been heard of, much less accomplished in history" see, Curzon G.N.,Persia and the Persian Question(1892) at pp.1,480 quoted in Shwadran B, The Middle East,Oil and the Great Powers(1985) at p.29 footnote 1. This concession was however cancelled in 1873, and a new one granted in 1889 until it was declared no longer valid. See, Shawdran B., id at pp.13-14.

[38] Longrigg S.H., ibid.

> was bound to form within two years a company or companies to carry out the concession, and on the establishment of the first of these was to pay to the Persian Government £20,000 in cash and a further £20,000 in paid-up shares. A royalty equivalent to 16% of the annual net profits was due to the Persian Treasury."[39]

The D'Arcy concession was later on taken over by the Anglo-Persian Oil company (the predecessor of B.P.) and in 1909 it opened up one of the largest oil regions in Persia.[40] Around this same time American companies were involved in winning concessions in Mexico and Latin America, the Dutch in the East Indies, Russian companies in Rumania and other British companies were focusing attention on the oil deposits of India and Burma.[41]

The period immediately following World War 1 brought into the limelight the importance of oil as an industrial and strategic substance. There were also growing fears of an oil shortage in the United States, and of the domination of the world market by oil trusts.[42] As a result American oil interests began to turn to the Middle East, whilst France asserted its claims to the concession rights previously held by Germany.[43] By the 1920s the oil industry was characterised by severe competition among the major companies to gain a foothold in new reserves as well as acquiring new markets.[44] British, French, and Dutch interests in the Turkish

---

[39] For a full text of the D'Arcy concession, see League of Nations, Official Journal,13th Year (1932) at pp.2305-2308.

[40] Brossard E.B., supra n.4, at p.24.

[41] Lax H.L.,Political Risk in the International Oil and Gas Industry (1983) at p.21.

[42] Mikdashi Z., A Financial Analysis of Middle Eastern Oil Concessions:1901-65 (1966) at p.66.

[43] Supra n.41.

[44] Rouhani F., supra n.1, at p.38.

Petroleum Company sought to keep American companies from obtaining concessions and U.S government protests led to the formation of the Iraq Petroleum Company (IPC) in which American companies were given about a quarter share.[45] In 1928 the companies negotiated the "Red Line Agreement" which in the words of Engler; [46]

> ".......marked off regions as open, closed or postponed for concessions, and developed patterns of cooperation in obtaining leases and in drilling.The most notable of these apportioned petroleum rights within a red line drawn around Iraq and the Arabian Peninsula areas of the old Turkish Empire broken up in World War 1.Through this 1928 Agreement Jersey [Standard Oil of New Jersey] and Socony joined Anglo-Persian, Royal Dutch/Shell and Compagnie Francaise des Petroles in ownership of the non profit Turkish Petroleum Company and control of what was then believed to be the richest Middle Eastern oil plum."

This agreement, which points to co-operation and the elimination of rivalry, thus opened up the entry of the American companies into the mainstream of oil exploration in the Middle East until it was dissolved in 1946.[47] The dominance of the oil companies persisted through the 1930s and the early 1940s with the grant of other concessions of importance in Saudi Arabia, Kuwait, Bahrain, Qatar, Abu Dhabi, and Oman.[48] Odell, for example, notes that during this period, the majors

> "....because of their international organization and structure and their effective control over supplies and reserves of crude oil...... were able to make the industry work in the way in which they wanted. The mutual understanding between the companies over supply and pricing

---

[45] Mikesell R.F., Petroleum Company Operations and Agreements in the Developing Countries (1984) at pp.20-21.

[46] Engler R., The Politics of Oil (1961) at p.68.

[47] For a detailed account of the formation and operation of IPC, see Blair J.M., The Control of Oil (1976) at pp.31-34.

[48] For a chronology of some major events in the foreign oil industry up to 1949, see Jacoby N.H., Multinational Oil (1974) at pp.40-41.

policies ensured their ability to earn high profits in this period."[49]

The face of the petroleum industry began to change gradually from the 1950s with the entry into foreign operations of Independent Oil Companies. The proliferation of Independents, such as Amoco, Atlantic Richfield, Getty, Marathon and other companies, stemmed from the increased demand for oil, the availability of unexplored areas and the promise of cheap oil abroad.[50] The independents, together with other European State Companies, made huge investments in the foreign oil industry and as a result began to compete with the established majors. Their aggressive posture and the willingness to accept more stringent contractual arrangements with the host countries in a large measure accounted for their success during this period. These events weakened the majors' ability to continue their cartel.

The changes in contractual terms that took place from the 1950s marked a gradual departure from the early concessions like that granted to D'Arcy in 1901. In the early stages of development, as already pointed out, the Oil Concession Agreement was the constitutive law of the joint enterprise between the private concessionaires and the host countries. These concessions formed the core of the legal relationships between the host countries and the IOCs, and were to determine the future course of events. Typically, they defined the rights, duties, powers and privileges of the parties and broadly speaking followed similar patterns prior to World War 1. The main elements of the traditional concession may aptly be summarised. They included;

---

[49] Odell P., supra n.5, at p.16.

[50] United Nations Centre For Transnational Corp.,Main Features and Trends in Petroleum Agreements(1983) at p.3.

> 1. A definition of the concession area within which the company was given the right to carry on exploration and oil development.(The concession area usually covered thousands of square miles,sometimes a major part of an entire country.)
> 2. A minimum amount of drilling that must be done over a period of time before the discovery of oil in commercial quantities.
> 3. The duration of the concession, which usually extended from sixty to seventy-five years.
> 4. The financial obligations of the company,which usually took the form of lump-sum payments, an annual rental, and royalties on each barrel of crude produced.
> 5. A provision for supplying the oil requirements of the local economy,either free of charge or at prices below those prevailing in world markets.
> 6. Installation rights and the right of eminent domain.
> 7. Certain special rights such as freedom from taxation other than that fixed in the contract,and the freedom from government controls over the conditions of production and marketing.[51]

It could be observed that the very nature of the early concession arrangement gave much freedom to the companies and even required prior company approval for a change in its terms.[52] The apparent reason for such generous terms to the companies was to quicken the development of national resources, since the host countries themselves were aware of the relatively privileged position the IOCs enjoyed under the traditional concession arrangements. As Rouhani notes,

> "The term 'concession' has on the whole acquired an unfavourable sense in Middle Eastern countries, so much so that at times its use has been condemned as derogatory to the national honor. Apart from the economic provisions, not overgenerous for the host country, that characterized it, what in particular gave to the concession an unwelcome connotation was its close association with the regime of

---

[51] Mikesell R.F., supra n.45, at p.21. See also, for a historical review of the traditional concession, Cattan H., The Evolution of Oil Concessions in the Middle East and North Africa (1967) at Chap.1.

[52] Mikdashi Z.,The Community of Oil Exporting Countries (1972) at p.43.

> capitulations and colonial practices."[53]

With the passage of time and the increasing importance of oil as a new source of energy, the shortcomings of the concession regime soon became evident. Rouhani states that:

> "The first objection raised against the concessions was that they represented transactions by which certain sovereigns,not yet subject to a constitutional regime, and indifferent to or unconscious of national interests, had granted without adequate consideration excessive rights to foreigners, on the strength of which they had appropriated to themselves a quasi-colonial authority. Indeed, the concessionaire did not consider himself as a party to an ordinary contract, but placed himself on the same footing as the government with which he had dealt. The concession easily became the instrument of an extra-territorial regime and gave the concessionaire an opportunity to interfere in the internal affairs of the host country."[54]

For the host states the concession contracts were being used as an instrument to promote the private commercial interests of an international oil combine, much to the detriment of the economic progress of their countries.[55] The companies, on the other hand, saw their role as increasingly important in the economic progress of the countries in which they carried out their operations. They were serving their own interests as well as those of the host nations. In this regard a former chairman of Aramco's board had this to say:

> "........that our contribution to the welfare of the United States and the free world is not inconsiderable. We represent a major American interest abroad. We have in the course of our operations made a major contribution to the development of an underdeveloped area.
>
> We have created an American interest in a vital resource and in

---

[53] Rouhani F, supra n.1, at pp.39-40. It should be noted that many of the concession arrangements in the Middle East and Asia took place while those countries were under European colonialism.

[54] Id.,at p.41.

[55] Stocking G.W., Middle East Oil (1970) at p.129.

> a vital area in the present world struggle. We are proud of our accomplishment......
> We seek no special privilege but I submit as an American and with a conviction bred of some 25 years experience in the oil industry of the Middle East that we serve in full measure the interests of both the United States and Saudi Arabia".[56]

It is suggested that the circumstances under which the early concession arrangements were made, as well as their terms, necessitated the revision of the agreements with the passage of time and changing conditions to accommodate the interests of both parties.[57]

The period beginning from the 1950s saw the governments of producing countries initiate a number of significant changes, not only to alter the position of the old concessions,but to create a new institutional environment within which to promote their national interests. The host countries took different approaches in their bid to correct the perceived imbalance in their relations with the oil companies. Renegotiation and revision of the existing early Middle-Eastern concession agreements took place and generally incorporated, inter alia, the following features:

1. the sharing in profits through direct taxation after 1950.
2. the virtual freezing of posted prices after 1960 and the calculation of profits for purposes of taxation on this basis ;
3. changes in the position of royalties in the calculation of taxes after 1964; and
4. provisions for the relinquishment of portions of the original

---

[56] U.S. Congress, Senate Sub commitee of the Committee on the Judiciary and Committee on Interior and Insular Affairs, 85th Cong.,1st Sess.,1957 Joint Hearings on the Emergency Oil Lift Program and Related Oil Programs Pt.2, p.1412 quoted in Stocking G.W., id., at p.122.

[57] For a detailed review of the conditions prevalent in each of the Middle Eastern countries, as well as an analysis of the concessions at that time, see Stocking G.W., id., at pp.123-139. An evaluation of the Concession-type contract will be made in Chapter 4.

concession area.[58]

Other forms of corrective measures resulted in nationalization or expropriation of the assets of the companies through legislative acts where the attempts of the host country to re-negotiate concession agreements failed. According to El-Salafy, such forms of action only did take place where;

> "The oil companies consistently resisted or ignored more modest demands under a claim of 'sufficient profit', used to justify the manipulation of petroleum production and prices for their own benefit."[59]

Nationalizations, however, did occur most often because the IOCs were very slow in responding to, or in making concessions desired by the host countries.

The spate of nationalizations, which began in Mexico as early as 1938 with the taking over of the Anglo-American oil companies, soon increased when other countries followed suit. The government of Prime Minister Mossadegh expropriated the properties of the Anglo-Iranian oil company in 1951,[60] and this phenomenon spread to the other oil producing countries like Iraq, which in 1961 revoked by virtue of Law No.80, 99.5 per cent of the concession zone placed at the disposal of the Iraq Petroleum Company (IPC) under the early concession.[61] Another law (Law No.97) in 1967 empowered the Iraq National Oil Company, formed in 1964, to explore and develop all the areas recovered from the IPC.[62] Algeria and Libya also adopted, amongst others,a common line of policy involving a series of acts ending in complete nationalisation of their oil industry in 1971 and 1974 respectively.[63] It must be noted that recourse to nationalisation by the individual host states, particularly in Mexico and Iran, were not without serious repercussions as the IOCs retaliated by shutting their oil out of the world market through the IOCs' control of transporting, refining and marketing of oil.[64] These isolated events in the producing states were to bring them together (through the formation of OPEC) against the companies.[65]

---

[58] The posted price is the 'tax reference' price for determining gross revenue upon which, after deduction of accounting costs, tax is levied. The system of posted prices was a device to maintain (a non-competitive pricing policies among the IOCs. See, Mikesell R.F. et al., Foreign Investment in the Petroleum and Mining Industries (1971) at pp.221-222.
Some background information as to the freezing of posted prices after 1960 would be useful here. Before 1950 and the introduction of a direct 50% taxation of profits there was no publicly announced selling price for crude oil at the Middle East points of origin. With the revision of the concession agreements on a 50-50 profit sharing basis, it became necessary to have crude oil reference prices for purposes of computing the profit on IOC operations within the producing countries. The practice of "posting" crude oil prices was started. During the 1950s the HCs were satisfied with revenues derived from the 50-50 profit sharing as calculated from posted prices. However, after 1957 changing market conditions less favourable to the IOCs necessitated the revision of their posted prices downward to bring them into closer conformity with the 'realized' prices in sales and transfer transactions. By 1960, this move had reduced HC revenue per barrel. HCs thus resisted the right of the IOCs to unilaterally effect changes in the posted prices and thus insisted upon being participants in decisions concerning posted prices. See, Schurr S.H, Homan P.T et al., Middle Eastern Oil and the Western World; Prospects and Problems (1971) at pp.120-121.

[59] El-Salafy A.M., The Nature of the Arab Oil Industry;An Historical Perspective (1974) at p.19.

[60] For a detailed account of the Iranian nationalization, see Shwadran B, supra n.37, at Chap.V.

The previous situation, where the oil companies had to deal with the producing countries individually, placed the companies in a much stronger position, since there was an almost total absence of cooperation or contact between the oil exporting countries. The need therefore to join their ranks to raise an effective voice against the IOCs during the period of heightening nationalism became uppermost. Although the immediate cause bringing OPEC into existence was a response to the unilateral reduction in posted oil prices by the IOCs, efforts to create such an organization date back to the establishment of the Arab League in September 1944.[66]

---

[61] Rouhani F., supra n.1, at pp.49-50.

[62] Ibid.

[63] Madelin H., Oil and Politics (1957) at p.73; See also Waddams F.C, The Libyan Oil Industry (1980) at Chap.12 for a fuller discussion of the revolutionary government of Libya's attitude towards the oil companies which resulted in the nationalizations of 1971 and 1974.

[64] It is worth noting that Iraq, Libya and the other oil producing countries where nationalizations occurred after 1961 were not exposed to the same problems faced by Iran and Mexico with the formation of OPEC that offered protection of its members' interests against collective sanction by the IOCs. See El-Salafy A.M., supra n.59, at p.23.

[65] Supra n.3, at pp.85-86.

The Baghdad meeting of September 14, 1960 at which government representatives from Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela were present, gave birth to OPEC. At its first meeting, the following resolutions were adopted;

> 1)That members can no longer remain indifferent to the attitudes adopted by the oil companies in effecting price modifications;
> 2)That members shall demand that oil companies maintain their prices steady and free from all unnecessary fluctuations;
> 3)That members shall endeavour,by all means available to them, to restore present prices to the levels prevailing before the reduction;
> 4)That members shall ensure that if any new circumstances arise that in the estimation of the oil companies necessitate price modifications, the said companies shall enter into consultation with the member or members affected in order to fully explain the circumstances.[67]

To give effect to the above-mentioned resolutions, member states also agreed to consult regularly with a view to coordinating and unifying their policies whenever circumstances such as those referred to in 2), arose.[68]

OPEC, which is a permanent inter governmental organization today, comprises the five founding members, in addition to eight other full members: Qatar, Indonesia,

---

[66] Rouhani F., supra n.1, at pp.75-77, See also, Ghanem S., OPEC - The Rise and Fall of an Exclusive Club (1986) at pp.21-23.

[67] OPEC, Official Resolutions and Press Releases 1960-1983(1984) at p.1. See also, Rouhani F, id., at pp.77-78.

[68] OPEC, ibid.

Libya, United Arab Emirates, Algeria, Nigeria, Ecuador, and Gabon.[69] It thus embraces Asian, African and Latin American states of different cultures, political systems and levels of development but held together by a common bond - the control of their oil resources.[70]

From its inception and throughout the 1960s, OPEC functioned as an information-exchange forum creating an awareness among its members and succeeded in changing the attitude of the IOCs (which until 1964 avoided any direct negotiations with OPEC) towards the oil exporting countries.[71] It succeeded in keeping posted prices at the August 1960 level as well as securing a change in Libya's petroleum law in 1965 that required profits to be computed on the basis of posted prices.[72] Another spectacular feat achieved during this era was its success in the revision of agreements between its members and IOCs as a result of which the payment of royalty was considered as an expense in the computation of income tax instead of the former situation where it was regarded as a credit against income tax.[73]

As the 1970s approached, the IOCs perceived OPEC as a phenomenon that was not going to stand the test of time. They were proved wrong, as this era rather saw OPEC, in the words of Odell, as representing "an important element in the growing sophistication of the oil producing world."[74] The supply / demand conditions which prevailed in the early 1970s and the Arab / Israeli hostilities boosted OPEC's strength and brought about increases in the posted price of oil and government revenues.[75] These events also prompted IOC recognition of the validity of producing country participation in producing operations.[76] However the IOCs responded to this state of affairs by shifting their efforts from one group of countries to another in pursuit of more secure and profitable sources of crude.[77] The companies thus turned their activities especially in the 1970s to such politically safe areas as Alaska and the North Sea.[78] It could be said that, the OPEC victory in the early 1970s was more or less short-term. However, due to diversion of IOC activities to other areas and the recession in the economies of the capitalist world, coupled with the effect of conservation on world oil consumption,[79] events in that period did demonstrate to its members the advantages of collective action. The IOCs also became increasingly aware that their own immediate interests (which is the maximization of their level of profitability within the shortest possible time) lay in cooperation with the oil producing countries.[80]

---

[69] OPEC Bulletin, Vol.XIX, No.1 (Feb.1988) at p.1.

[70] Lenczowski G., "The Oil Producing Countries" in Vernon R., ed., The Oil Crisis (1976) at p.59.

[71] Ajami R.A., Arab Response to the Multinationals (1979) at p.43.

[72] See supra n.58.

[73] Exxon Corp. Background Paper quoted in (1988) 21 International Petroleum Encyclopedia at p.14. By so doing income tax payments due to the host countries were increased several cents per barrel (although this was relatively insignificant). For an account of improvements in the financial arrangements between the IOCs and OPEC countries during this period see, Ghanem S., supra n.66, at p.107.

---

[74] Supra n.5, at p.107.

[75] Id., at p.108.

[76] Ibid.

[77] Tanzer M., & Zorn S., Energy Update (1985) at p.82.

[78] Ibid.

[79] Ibid.

[80] Supra n.5, at p.108.

In recent times, although OPEC is not as important as it was in the early 1970s and 1980s in unilaterally setting world oil prices, one would agree with the view that both the IOCs and the OPEC countries have common and contradictory interests to protect. They include the prevention of an oversupply of oil in the world on one hand, and on the other, the oil companies' reluctance to see OPEC countries increasing their percentage of the government "take" (i.e.revenue per barrel). The oil companies and OPEC are united in their desire for high prices for oil since this implies a high return for them. Their interest therefore lies in limiting competition that would lead to price cuts or a rapid development of new reserves. On the other hand, their contradictory interests lie in the fact that each side wants a greater share of profits. As a result, OPEC would benefit to some extent from the presence of alternatives to the majors since they can make better arrangements. The oil companies have an interest in expanding their sources of supply outside OPEC as a way of creating a threat through their capacity to move elsewhere, if their profit margins drop too low.[81]

The future of OPEC's success depends on many factors both within and outside the organization itself, but looking back on the international scene, OPEC has been in the words of Mikdashi[82]

> ".......a key contributor to the changing character of the international system, and as a catalyst in the formation of new political relations both among nations and between nations and major "transnational" enterprises. It has already had its influence both as a protagonist in the international system and as a model to be emulated by other resource-rich underdeveloped countries. The remarkable fact about OPEC is

---

[81] See Laxer J., Canada's Energy Crisis (1975) at pp.10-11.

[82] Mikdashi Z, "The OPEC Process",in Vernon R, ed., supra n.70, at p.214.

> that it proved to be a reasonably effective force for arriving at consensus,narrowing the differences in policies among member governments, and contributing to collective action."

Host country / IOC relations today represent a great departure from the formative years of petroleum development. The course of these relations however, as we have seen, was largely determined by the particular interests of both company and country at each period in time.

In the quest for development however, IOCs will continue to play a significant role so long as these countries lack the necessary risk capital and technology. Contrary to currently held views about diversification of operations into politically safe areas such as the U.S. and the North Sea,[83] IOCs have intensified exploration efforts, for example in Africa, due to the highly attractive contractual terms being offered. [84] It is, however, suggested that those countries, though desirous of speeding up exploration, must be very cautious not to give so much away, as the situation may arise where contractual terms might slip back to the low levels of the 1950s.[85] Of course, the particular bargaining power of each individual country may vary, since countries in which there are moderate geological prospects would be unlikely to negotiate as good a contract as a country which has already proven oil reserves.[86] However, it is suggested that modern improved methods of seismic survey should readily reveal the potential reserves of an area before any exploration can be done. The point is that improved methods of determining a potentially oil bearing zone made possible by modern-day advances in technology should reduce the sinking of "wild-cat" exploratory wells, and this must go to reduce risk capital required for initial investment.

---

[83] Many operators plan to shift from these areas which threaten to show a lower rate of return, see id.

[84] International Petroleum Encyclopedia, supra n.73, at p. 287.

[85] See Tanzer M., "Negotiation Strategies and Objectives in Petroleum Exploration and Development Agreements" in U.N., Petroleum Exploration Strategies in Developing Countries (1982) at p.216.

[86] U.N.C.T.C., supra n.50, at p.4.

Governments today could predictably obtain better terms and maintain good relations with the IOCs if IOCs maintained a greater degree of flexibility in their dealings. This is necessary for the overall development of the world's oil resources. If the alarming rate of hydrocarbons now being consumed is anything to go by, mutually workable relations must be maintained now and for the future.

As stated at the beginning of this chapter, it is important that developing countries wishing to embark on oil development must have a first-hand knowledge about the workings of the oil industry. The background information acquired towards this end will help the country in fashioning whatever policies and laws should form the basic framework from which it will proceed.

An insight into the structure and operations of the IOC, as we have seen thus far, underlines the changes in policies and attempts by host countries to restructure the existing legal regime governing petroleum agreements as we shall see in the following chapters of this thesis.

CHAPTER TWO

THE INTERESTS OF HOST COUNTRIES AND INTERNATIONAL OIL COMPANIES UNDER PETROLEUM DEVELOPMENT ARRANGEMENTS.

1. Introduction:

In designing a good International Petroleum Agreement, it is necessary to consider the primary objectives of the host country vis-a-vis the private investing organization. This is very important when it comes to negotiating the terms of the agreement. The parties must always address themselves to the issue of what their respective interests are, and how they can be accommodated in structuring a good petroleum contract that will be mutually beneficial. In this chapter, therefore, an attempt will be made to outline the objectives or considerations that underline petroleum arrangements between HCs and IOCs. For some developing countries, which have not had any experience in the field of petroleum development, the formulation of law and policy means breaking new ground; for others who have had some experience in this field, laws and policies must be constantly re-appraised and reformulated in the context of a new global environment.

It should be noted from the outset that, although an attempt will be made to paint with a broad brush the objectives that host countries must consider in formulating their policies and laws, there cannot be a universal prescription. Petroleum development policies can only be devised and applied in the light of the specific circumstances in each individual country. This will have to be done on the basis of each country's socio-economic goals and its own perception of its development priorities.

It should be pointed out that in formulating strategies for oil development, HCs must constantly bear in mind that their interests may not necessarily coincide with that of the IOCs.[1] The role of IOCs must be viewed in the context of their basic nature as enterprises concerned with the maximisation of profit over time from their overall global operations.[2] For the policy maker in a developing country, therefore, some tough choices have to be made and there are a number of ways of structuring policies and laws to address the broad objectives of the investor and HC.

2. Objectives of Host Governments:

Broadly speaking, there are a number of objectives that most governments of developing countries will seek to attain through petroleum development.

The first consideration is for the HC to seek rapid exploration of its territory so as to have a full assessment of the country's potential. Once the full potential of the country is ascertained, the HC must ensure that production and development of its petroleum potential is carried out in a manner that maximizes ultimate total recovery and ensures maximum long-term benefits to the country.[3] One way of speeding up exploration is for the HC to have a data package of the geological and geophysical survey of the potential oil bearing areas of its territory.[4] The availability of such information on national petroleum resources can be acquired through exploration carried out by the government or through the government's entitlement to receive detailed information from an IOC's exploration program.[5] Information collected by the government may have a considerable commercial value and may be sold to IOCs, thus reducing the HCs costs.[6] This can also enable IOCs to determine the areas of interest in a much more efficient way. The accumulation of geological information may be achieved through the grant of non-exclusive exploration permits (sometimes called "reconnaissance permits") on reasonable terms.[7] The risks involved in oil exploration can thus be reduced considerably by relatively inexpensive preliminary surveying efforts.[8]

---

[1] For an in-depth discussion of the primary approaches to the relationships between the Transnational Corporation and the State, see Lax H.L., States and Companies - Political Risks in the International Oil Industry (1988) ; Kuusi J., The Host State and the Transnational Corporation - An Analysis of Legal Relationships (1979).

[2] Hossain K., Law and Policy in Petroleum Development (1979) at p.37.

[3] Barrows G.H., International Petroleum Industry (1968) at p.231.

[4] U.N.C.T.C., Alternative Arrangements for Petroleum Development (1982) at p.7.

Due to financial strains arising out of foreign exchange costs and the concern over the risk of increased price of imported oil,[9] petroleum development must be geared towards meeting the domestic petroleum needs of the HC.[10] This would have the effect of reducing costs and uncertainties caused by reliance on oil imports.

---

[5] Barrows Company Inc., World Petroleum Arrangements (1982) at p.12.

[6] Ibid.

[7] Ibid.

[8] Tanzer M., The Political Economy of International Oil and the Underdeveloped Countries (1969) at p. 133.

[9] About ninety-two developing countries depend on imported oil supplies. Countries such as Chad, Ghana, Ivory Coast and Pakistan have indications of becoming self-sufficient in the near future. Of this number, however, there are others such as Brazil, Korea and Turkey which have an increasing demand for oil that could make them become more and more dependent on oil imports unless they develop other sources of energy. Of the ninety-two import dependent countries, there are at least sixty-four which rely on imports for more than 75% of their national commercial supplies of energy. See, Halbouty M.T., "World Petroleum Reserves and Resources with Special Reference to Developing Countries" in U.N., Petroleum Exploration Strategies in Developing Countries (1982) 3 at p.12. For an account of the oil consumption situation in oil-importing developing countries generally, see Ghadar F., Petroleum Investment in Developing Countries (1982) at Chap. 1.

[10] Supra n.4.

Another particularly significant HC objective must be to secure maximum revenue and foreign exchange benefits from petroleum production. The realisation of this objective will depend on the institutional structures put in place as well as the contractual terms agreed upon between the HC and the private investor.[11]

HCs should endeavour to develop national capability, with the ultimate goal of exercising effective control over the petroleum industry. Closely linked to the issue of effective control is the development of the necessary domestic technical and administrative expertise to which particular attention must be paid. This is significant in the sense that policies geared in this direction will have the long-term effect of making them self-reliant and reduce their dependence on IOCs for oil development.

Environmental protection and minimisation of pollution concerns which have gained importance lately must be seriously addressed under petroleum contracts. Petroleum activities must not adversely affect other activities such as fishing, navigation, tourism and land conservation.

In sum, the HC must seek to exercise the maximum national control over the petroleum industry, so as to achieve other national objectives and to ensure that petroleum-sector activities are consistent with national plans and policies.[12]

2.1. Constraints on the development of a good petroleum arrangement on the part of Host Countries:

Though HCs seek to achieve the objectives outlined above, they face a number of problems in their bid to develop their petroleum potential. In countries where little exploration has taken place and where the geological prospects are poor, exceptionally generous terms may be necessary to attract IOCs in negotiating contracts. Drilling expenditures may produce dry holes or only small discoveries. In such instances, uncertainty may pervade the complex relationship which arises between investment decisions and outcomes which occur throughout the various stages of the petroleum development process.[13]

---

[11] For a discussion on ways of maximising government revenue and the bearing of fiscal risk, see Mikesell R.F., "Profitability and Risk in Third World Petroleum :the Host Government Perspective" in Khan K. ed., Petroleum Resources and Development (1987) 156 at pp.159-162.

[12] Supra n.4.

There is also the problem of the HCs' capability to oversee, control and operate the petroleum industry.[14] The lack of necessary expertise to audit and control costs incurred by contractors may result in a significant amount of potential revenue being siphoned off in the form of inflated or unjustified costs.[15] The HC requires the necessary skilled personnel. Attempts must be made to build up a pool of manpower resources to fully handle and enforce a highly sophisticated petroleum arrangement.[16] In the interim, the HC can seek external assistance in this direction. To speed up the process of effective government control, it has been suggested that a strong provision be included in a government-company agreement calling for assignment of nationals to on-the-job training (e.g. joint company-government committees on procurement, technical aspects of operations etc.).[17] This way the

---

[13] Broadman H.G., & Dunkerly J., "The Drilling Gap in Non-OPEC Developing Countries:The Role of Contractual and Fiscal Arrangements" (1985) 25 No.3 Natural Resources Journal at p.415.

[14] Supra n.4, at p.8.

[15] Ibid.

[16] Ibid.

[17] Ibid.

HC nationals actually get the routine oil industry experience.

Another limitation on the HC concerns its own crude oil supply position and needs.[18] The HC may require that any oil discovered be used to supply domestic needs. In some cases countries may prefer to export their own oil while importing oil from other outside sources, because this sort of arrangement may be more profitable. The reasons for this may lie in the lack of need of the HC for high grade crude or partly because of the high costs of transporting oil from its domestic source to the domestic users.[19] In some cases, an IOC may be interested in sources of crude for its facilities elsewhere, thus its interests may not coincide with that of the HC.[20]

Finally, the political risk factor as a disincentive to oil exploration cannot be discounted. IOCs are reluctant to venture into countries where there is evidence of political instability. This engenders fear of total or partial loss of investment after discovery and production of petroleum, or at the least erodes the initial financial expectations of the IOCs.[21]

3. International Oil Company Objectives:

IOCs regularly appraise and compare opportunities for investment around the world. No company will go into an exploration venture with the expectation of losing money. The investor's interests and expectations are geared towards a profitable allocation of its financial resources, i.e. to achieving a reasonable return on investment, taking into account the exploration risks, the long-lead time between exploration and exploitation and the long pay-out period for recovery of the original investment.[22] The ultimate question that motivates IOCs to invest can aptly been summed up thus;[23]

---

[18] Ibid.

[19] Ibid.

[20] Ibid.

[21] It has been suggested that in practice, however, political risk has not had a great or uniform impact on the behaviour of foreign companies, since they take into account the 'investment climate' and its suitability to their objectives before deciding on an investment venture. See, Zakariya H.S., "Petroleum Exploration in Developing Countries:The Need for a Global Strategy based on Public Policy" in U.N., supra n.9, 243 at pp.248-249. For a detailed account of political risk in the oil industry generally see, Lax H.L., Political Risk in the International Oil and Gas Industry (1983). See also, Kinna J.C., "Investing in Developing Countries: Minimisation of Political Risk" (1983) 1 Journal of Energy and Resources Law at pp.89-99.

> "given the present knowledge about the geology,the operating environment, and the various risks associated with the project, do the potential earnings justify the monetary loss that will occur if the project is unsuccessful".

Thus the primary aim of IOCs in oil development arrangements, as already pointed out, relates to the profitability of the venture in question. They must maintain an adequate profit margin. The majors, for example, are interested in oil fields capable of making a significant contribution to their world-wide needs for supplying their own downstream operations.[24] Their interests therefore lie in projects that promise not only a high rate of return, but also a return that is large enough in absolute terms.[25] The independents or the smaller companies may not necessarily have interests identical to the majors. However, it must be remembered that,irrespective of the size of the IOC in exploration, or the size of the oilfield explored, the bottom-line is always the profit motive. IOCs are therefore highly interested in contractual and fiscal terms for foreign investors that are flexible enough to accommodate their interests.

---

[22] Blinn K.W., Duval C., Le Leuch H., et al., International Petroleum Exploration, Exploitation Agreements - Legal,Economic & Policy Aspects (1986) at p.225.

[23] United States National Petroleum Council, Third World Petroleum Development: A Statement of Principles (1982) at p.9.

[24] Supra n.4, at p.9.

[25] Ibid.

Hossain,[26] for example, identifies at least five areas where IOCs interests lie. These interests may conflict with that of HCs. These are generally, 1. The rate and extent of exploration. 2. Rate and extent of development. 3. Rate of production. 4. Transfer of skills and technology,as well as training. 5. Sharing of financial returns and pricing. It would be worthwhile to briefly examine these interests.

First, an IOC which acquires exploration rights has an interest in the making of a commercial discovery. The considerations, however, which affect its decision as regards the rate and extent of exploration are dependent upon the position of the particular company in terms of exploration rights and sources of supply held by it in other areas.[27] This also includes the needs of its marketing outlets and the funds available to it.[28] Following from this, an IOC which is "short on crude" in relation to its marketing outlets is likely to share the HC's objective of rapid exploration.[29] On the other hand, a company which has other sources of supply might decide to "sit on" any significant discoveries made in the event of a glut in its marketing outlets. It would therefore allow the areas acquired by it to lie idle or carry on very little work to give an appearance that some work is being done.[30] An IOC would therefore, aim to retain the maximum freedom of action so far as the rate and extent of exploration is concerned.

---

[26] Supra n.2, at pp.44-46.

[27] Id., at p.45.

[28] Ibid.

[29] Ibid.

[30] Ibid.

Second, although IOCs have an interest in rapid development of any reservoirs which are discovered, they have to take a decision on the rate and extent of development, again within the global framework of their worldwide operations.[31] The considerations just noted above apply here too. Hossain,[32] cites a vivid example of the IOCs 'go-slow' attitude towards the rapid exploration and exploitation of the North Sea oil potential from the period beginning from 1971. This was a result of the drastic alteration in the relations between the IOCs (especially the majors) and OPEC governments at that time which was highly favourable to the companies in the short to medium term. The companies had thus achieved an agreement with OPEC which not only left them in control of the international oil system for another decade, but one which also gave them a positive incentive to get as much as possible of the oil they had discovered in OPEC countries out of the ground and into the markets of the world in the period up to 1982. By 1982, rapidly rising oil prices allowed HCs to demand a substantially increased share of both profits from and control over operations. Some HCs during this period imposed harsh new terms and tried renegotiation of existing agreements (-a strategy which succeeded as long as prices continued to rise). Odell for example, commenting on the situation in which some European governments found themselves has stated that:

---

[31] Ibid.

[32] See id., at pp.47-48 quoting Odell P., 'The Economic Background to North Sea Oil and Gas Development', in Saeter M., & Smart I., eds., The Political Implications of North Sea Oil and Gas (1975) 51 at p.54.

> "European governments either lacked or did not seek access to alternative intelligence and thus accepted the very strongly commercially motivated presentations of the interested oil companies concerning the 'limited' potential for North Sea Oil over the next decade."[33]

This describes the sort of divergence in interest that may exist between IOCs and HCs with regard to the development of potential sources of oil within their territories. Where arrangements between HC and IOC leave the latter with freedom of choice, situations could arise where the company , within the global context of its operations, may decline to invest in the reservoirs it has discovered.[34]

Third, another area where IOCs' interests may not coincide with that of the HC relates to decisions concerning the rate of production, growth of production and levels of output.[35] IOCs may "programme...production, orchestrating different levels drawn from their different sources".[36] They may either increase or decrease the level of production depending on the economically relevant time period.[37]

> "By doing this the companies seek either to maximise their returns on investment or at least to make certain of achieving maximum acceptable levels of profitability on the development of a field. By doing more about the exploitation of a field, a company's return on investment will start to fall and, given normal and acceptable commercial behaviour, there should be no expectation that more will, indeed, be done.........."[38]

---

[33] Ibid.

[34] It is proposed to examine in chapter 4 how contract regimes put in place by HCs seek to deal with these situations.

[35] Supra n.2, at p.49.

[36] Ibid.

[37] Odell P.R., & Rosing K.E., Optimal Development of the North Sea's OilFields - A Study in Divergent Government and Company Interests and their Reconciliation (1976) at p.49.

[38] Ibid.

A modus operandi to accommodate HC-IOC interests would be to include provisions regulating production,[39] and the requirement on the part of an IOC to conform to "good oilfield practice".[40]

Fourth, the basic strength of multinationals in general in their dealings with governments lies in their possession of technical and managerial skills.[41] The argument has been put forward that the structure of the world petroleum market discourages IOCs from effecting transfer of skills to National Oil Companies for:

> "As nationalisation proceeds, the state companies typically become competitors of the established international firms in their developed country markets. For this reason, the more experienced is the international firm,the less happy it is to share its skills with state enterprises......As long as producing-state companies are viewed by the most important international companies as potential disruptors of market shares and profits in the industry, the established firms will have a natural reluctance to transfer technology and management skills to Arabs and OPEC nationals".[42]

It should be pointed out that although the larger national oil companies have become effective in their operations within their respective countries, they have not sufficiently developed their operations on the international scene as to pose a major problem for the IOCs today. However, if HCs are to safeguard their own interests with a view to undertaking operations themselves, then, as already noted, transfer of technology and training obligations must be clearly specified in country-company agreements and closely monitored by the latter.[43] In China, however, the State Oil Company's (China National Offshore Oil Corporation) policy in the development of China's offshore petroleum reserves has been to introduce more lenient provisions on the contractor's obligations to undertake training of Chinese nationals and technology transfer.[44] The rationale behind this policy has been to mitigate the financial burden on the IOCs.[45] It is suggested, however, that whereas this policy is laudable in the short-term, its long-term effects might not always be in the national interest if the national priority envisages the eventual control of its oil industry by local personnel and expertise. This is necessary to reduce dependence on the IOCs.

---

[39] For a discussion on how the British government used regulatory powers in an attempt to control the rate of production in the North Sea oilfield for example, see Cameron P.D., Property Rights and Sovereign Rights: The Case of North Sea Oil (1983) at pp. 117-130.

[40] There are some technical and economic considerations involved in the development of an oilfield. For an analysis of these possibilities as applied to the development of the North Sea oilfield, see id., at Chaps. 6 and 7.

[41] Supra n.2, at p.51.

[42] Franko L.G., "Arab Countries and Western Oil Companies: Is Co-operation Possible?", Paper read at the Seminar on Administration of the Oil Resources of Arab Countries, Tripoli, April 1974, at p.4, quoted in id., at p.52.

Sharing of the total net revenue generated by petroleum exploitation could also be a major source of conflict between HCs and IOCs.[46] Hossain, notes that an IOC expects to secure the largest margin of profit and the recovery of total investments within the shortest possible time.[47] The HC, as sovereign over the territory in which the resources occur and as owner of the resources, expects increasing proportions of rent generated by the petroleum operations.[48] The HCs seek to take their share of the rent in the form of royalties, taxes, share in the profits, or a share of the production or a combination of these. The methods for computation of the shares have also been a source of controversy.[49] It is sufficient here to highlight the basic objectives of the HC and IOC as a necessary background against which each party would have a clear perception of what to look for with respect to the various contractual systems that exist in the international petroleum industry.

---

[43] Id., at pp.51-52.

[44] See Dehua Y.,"Incentive Policy and Measures Adopted in China on Offshore Petroleum Exploration and Development on the Basis of Mutual Benefit" (1988) Energy Law p.793 at p.795.

[45] Ibid.

[46] Supra n.2, at p.52.

[47] Ibid.

[48] Ibid.

HCs must recognise the fundamental requirements of IOCs and IOCs must recognise HCs legitimate interest in regulating petroleum operations in the national interest and in achieving a fair price for their resources. This recognition could be achieved if responsiveness and security are taken account of. The state needs a certain degree of responsiveness to further its interests - whether budgetary, political (energy) or environmental.[50] The investor, on the other hand, needs a certain degree of planning and investment security.[51]

---

[49] Id., at p.53.

[50] Kuehne G., "Responsiveness and Security within Resource Regimes" (1988) Energy Law 319 at p.342.

[51] Ibid.

CHAPTER 3

THE ROLE OF INSTITUTIONAL AND LEGISLATIVE MECHANISMS IN THE PROMOTION OF PETROLEUM DEVELOPMENT IN DEVELOPING COUNTRIES

1. Introduction:

The clarion-call in developing countries in the past decade has been to restructure institutions and laws to deal in a much more efficient manner with undertakings related to petroleum development. This call is an attempt at translating into reality the principles embodied in the concept of Permanent Sovereignty over Natural Resources, against the background of the call for a New International Economic Order.[1] In an attempt to look at the institutions and laws set in place in these countries, it is pertinent to draw upon the origin, nature and development of these concepts, and how they have shaped the institutions and legislative mechanisms employed in recent times in Host Countries (HC).

This chapter focuses on how the principles of permanent sovereignty have already resulted in sophisticated techniques in dealing with IOCs and how they are likely to develop further in this direction in the future. Also, national oil companies (NOCs) which are now a prominent feature in most developing countries have become important institutions in the drive towards accelerated petroleum development in these countries. The establishment of NOCs arises from the doctrine of HCs' sovereignty over their natural resources and the need to protect their own interests in the natural resource sector. NOCs acting as instruments of national petroleum policy would thus be expected to play a prominent role in achieving for HCs stable legal regimes for petroleum development. An attempt is made to discuss the objectives, powers, structure and administration, judicial control and finally, the role of national oil companies in developing countries. Once the NOC is established it is necessary that the appropriate legislative mechanism is used to facilitate its smooth operation, and the realization of the overall developmental goals of the state. The relative merits and demerits of legislative mechanisms are addressed. As noted, the basic institutional and legislative framework within which the HC must operate are particularly important in the drive towards the creation of a stable legal regime within which petroleum development must take place.

---

[1] It is very difficult to define the term New International Economic Order. Annel and Nygrem, however,provide a summary of what the new international economic order is all about. They suggest that "[an] international economic order must reasonably refer broadly to the rules of the game which regulate the economic cooperation of sovereign states in various spheres and which are sustained by the existing distribution of power. These rules include the charters and procedures for decision-making of international organizations as well as other rules, regulations and norms. The system applies to states but also to other actors in the international arena, e.g., transnational corporations, shipping companies and individual human beings. See, Annel L., & Nygren B., The Developing Countries and the World Economic Order (1980) at p.119.

2. The principle of permanent sovereignty over natural resources

a. Historical background and development of the concept in the United Nations General Assembly:

This principle has become one of the key elements of the urgent call by developing countries for a new international economic order. The doctrine first emerged,took shape and became consolidated under the various United Nations General Assembly (GA) Resolutions. Permanent sovereignty over natural resources means that HCs should exercise control over their natural resources, including issues relating to development, exploitation and marketing so as to ensure the best possible use of these resources.[2] A fundamental attribute of state sovereignty relates to the fact that every state has the right to pass laws governing the allocation, use, disposal and distribution of its resources and to regulate economic activities within its territorial jurisdiction.[3] Thus the state or owner of the resource may prevent foreign access to the resources within its territory. But, as is often the case with developing countries, lack of skill or capital required to extract, gather or process these resources necessarily requires foreign access to them. Where such access is granted, conflicts may result over the distribution of the proceeds between those who control the access and those applying the necessary skills, capital, and means of distribution.

The core of the conflict as to resource accessibility and operational conditions between the owner of the resources and those who gain access to them may be better understood if we look at developments in the past.

The idea of permanent sovereignty over natural resources, which was first mooted by developing countries in the early fifties, was "inextricably linked with colonial history and the process of decolonization".[4] Until a few years ago, most developing countries were either colonies or economic and political dependencies of one of the developed countries of the West. Policies taken in the name of any of these countries were directly aimed at protecting the interests of the colonial or metropolitan power.[5] Thus under colonial rule as aptly summed up by Mughraby:

---

[2] Kemper R., "The Concept of Permanent Sovereignty and its Impact on Mineral Contracts" in Legal and Institutional Arrangements in Mineral Development (1982) at p.29.

[3] Ibid.

[4] Id., 29 at p.30. See also, Flint D, "Foreign Investment and the New International Economic Order", in Hossain K, & Chowdhury S.R., eds., Permanent Sovereignty over Natural Resources in International Law (1984) 144 at p.145.

> ".......foreign capital and know-how were applied to a very limited sector of the economy. The purpose was to produce those minerals and raw materials which were needed by the industries of the metropolitan power. Thus the development of natural resources did not take into account the needs of economic integration in the domestic market. Such limited operations constituted, in fact, tiny economic enclaves wholly owned and managed by foreign enterprises. These enclaves were virtually isolated from the structure of the native economy, and existed practically as an extension of the industrial economy of the colonialist power."[6]

Decolonization and the advent of political independence of the former colonies did not change the pattern of economic relations described above. During this period, the foundations of an international economic order marked by growing inequalities had already been established. Girvan notes that:

> "[a]t one end of the system stood the United States, closely followed by Western Europe and Japan, the centres of advanced industrial capitalism, characterized by sustained economic growth and technological progress, almost full employment, structurally transformed and flexible economic systems, and a considerable amount of international economic,financial and military power. At the other end lay the countries, variously called 'underdeveloped', 'developing' or 'Third World', that included majority of nations and peoples in the world. These lay at the periphery of the international capitalist system and were characterized by underdevelopment and dependent economic systems and by a low standard of living for the overwhelming majority of their populations. The two ends of the system were - and continue to be- linked by complex relationships, marked by profound inequalities in power, in the international division of labour, and in the international distribution of income".[7]

The developing countries realised that political independence by itself did not have much meaning if efforts were not directed to control and to restructure their economies. A new wind of economic nationalism,[8] began to blow as the emergent nations were no longer inhibited from putting into effect economic policies they considered to be in the interest of their own national aspirations and development.[9] The aim of economic independence became one of achieving economic sovereignty.[10] Natural resources represented the only economic assets of these emergent states. National sovereignty was, however, to be reached at the cost of the least possible disintegration in the international relations of the HCs and the foreign interests in the control of natural resources.[11]

---

[5] Mughraby M.A., Permanent Sovereignty over Oil Resources (1966) at p.3.

[6] Id., at p.12.

[7] Girvan N., "Economic Nationalism" in Vernon R, ed., The Oil Crisis (1976) 145 at pp.146-147.

By the end of the 1960s, the growing importance of the socialist countries and the rise of Third World influence in the United Nations (U.N) became felt. The international climate began to shift in the direction which made it favourable for the assertion of economic nationalism, particularly in the area of sovereignty over natural resources.[12] The historical background to the development of the concept of permanent sovereignty over natural resources, therefore, can be seen as one of "struggle between private foreign investment and the interests of the capital-exporting countries on the one side, and the interests of the capital importing countries and their economic and development goals on the other side".[13]

---

[8] The concept of economic nationalism was born in the West and later borrowed by the developing countries. Economic nationalism was the general condition under which the Welfare State came into being in the developed nations of the West. See, Flint D., supra n.4, at pp.8-12;Myrdal G.,Economic Nationalism and Internationalism (1957).

[9] Mughraby M.A., supra n.5, at p.4.

[10] Id.,at p.13.

[11] Ibid.

[12] Supra n.5, 145 at p.153.

b. Origin and development of the concept of permanent sovereignty over natural resources:

This subject as indicated earlier on was first raised in 1952 by delegates of underdeveloped countries in the United Nations, as a result of the strong and deep-rooted socio-economic trends already noted above.[14] The rationale behind its introduction was to call upon the U.N. to play a major role in helping developing countries to achieve economic independence. The U.N. was to be called upon to play a similar role to that which it had played in assisting those countries to gain their political independence.[15] To the emergent states therefore, the two roles were so interconnected that they were viewed as inseparable.[16]

The principle has been formulated and reiterated in a number of General Assembly resolutions. This development was however, not without controversy. There was a polarisation of ideas between the capital exporting states on one hand, and the less developed, capital importing states on the other, as to what should be subsumed under or embodied in this concept.[17] The long series of resolutions on the subject may be divided into three phases. The first phase is characterised by emphasizing the right of peoples to use and exploit their natural resources as a right 'inherent in their sovereignty'. In a resolution entitled 'Integrated economic development and commercial agreements', the General Assembly recommended:

---

[13] *Supra* n.1, 29 at p.30.

[14] The concept was first introduced into debate on the Human Rights Covenants by Chile in 1952. The U.N. was at that time engaged in formulating the principles of self-determination as a basis for the draft Covenants on Human Rights and the concept of permanent sovereignty emerged as an expression of the principle of economic self-determination. See, U.N. Doc.E /CN.4/ L.24.

[15] *Supra* n.2, at p.14.

[16] *Ibid*.

[17] It is not intended here to discuss the various debates that preceded the formulation of the U.N. resolutions on the concept. For a detailed analysis of the various viewpoints on this subject-matter, see, Hyde J.N., "*Permanent Sovereignty Over Natural Wealth and Resources*"(1956) 50 American Journal of International Law, at p.854; Gess K.N., "*Permanent Sovereignty Over Natural Resources* " 13 International and Comparative Law Quarterly, at p.398; Banerjee S.K., "*The Concept of Permanent*

> "that Members of the United Nations within the framework of their general economic policy, should ......consider the possibility of facilitating through commercial agreements.....the development of natural resources.....,provided that such commercial agreements shall not contain economic or political conditions violating the sovereign rights of the underdeveloped countries, including the right to determine their own plans for economic development."[18]

On December 21 1952, the General Assembly adopted Resolution 626 (VII), and subsequently in 1954, Resolution 837 (IX), which were entitled respectively 'Right to exploit freely natural wealth and resources', and 'Recommendations concerning international respect for the right of peoples and nations to self-determination'. These echoed the fact that modalities for the exercise of permanent sovereignty must conform with regard for the rights and duties of states under international law and the need for maintaining the flow of capital, as well as the creation of conditions conducive to security, mutual confidence and encouragement for international co-operation. Thereafter a survey of the status of permanent sovereignty over natural wealth and resources as a basic constituent of the right of self-determination, was

---

Sovereignty over Natural Resources - An Analysis" (1968) 8 Indian Journal of International Law at p.515; O'Keefe P.J., "The United Nations and Permanent Sovereignty Over Natural Resources" (1974) 8 Journal of World Trade Law at p.239; Mughraby M.A., supra n.5, at Chap.2; Elian G., The Principle of Permanent Sovereignty over Natural Resources (1979) at pp.83-124.

[18] See, G.A. Res.523 (VI) February 12, 1952.

conducted by the U.N. Commission on Permanent Sovereignty.[19] This culminated in the adoption of resolution 1803 (XVII) of 14 December 1962 commonly known as the U.N. Declaration on Permanent Sovereignty over Natural Resources, which marked the beginning of the second phase of resolutions on the subject. This has been popularly described as the landmark resolution,[20] and a kind of watershed since it is the last substantive resolution on the subject for which an accommodation of interests was reached between the capital-exporting and the capital-importing countries.[21] The salient portions of the declarations in the resolution read as follows:

> "1. The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the state concerned.
> 2. The exploration, development and disposition of such resources as well as the import of the foreign capital required for these purposes, should be in conformity with the rules and conditions which the peoples and nations freely consider to be necessary or desirable with regard to the authorization, restriction and prohibition of such activities.
> 3. In cases where authorization is granted, the capital imported and the earnings on that capital shall be governed by the terms thereof, by the national legislation in force, and by international law. The profits derived must be shared in the proportions freely agreed upon,in each case,between the investors and the recipient State, due care being taken to ensure that there is no impairment, for any reason, of that State's sovereignty over its natural wealth and resources.
> 4. Nationalization, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be

---

[19] This commission was established under G.A.Res.1314 (XIII),12 December 1958.

[20] Chowdhury S.R., & Hossain K., supra n.4.

[21] See, supra n.1, 29 at p.30. See also, Banerjee S.K., supra n.17, 515 at pp.528-535 for a discussion on the debates which preceded G.A.Res.1803 (XVII).

> paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law. In any case where the question of compensation gives rise to controversy, the national jurisdiction of the State taking such measures shall be exhausted. However,upon agreement by sovereign States and other parties concerned, settlement of the dispute should be made through arbitration or international adjudication.
> 5. The free and beneficial exercise of the sovereignty of peoples and nations over their natural resources must be furthered by the mutual respect of States based on their sovereign equality.
> 6. International co-operation for the economic development of developing countries, whether in the form of public or private capital investments, exchange of goods and services, technical assistance, or exchange of scientific information, shall be such as to further their independent national development and shall be based upon respect for their sovereignty over their natural wealth and resources."

The resolution emphasizes that the interests of the State and its nationals[22] take precedence over all other interests. The State therefore is entitled, in changing circumstances,[23] to take such action and to introduce such legislation as may be required for the furtherance of the interests and welfare of its nationals. In situations where foreign capital and technology have been invited to participate in the development of natural resources, the relationship between the HC and the foreign investor is to be governed by the agreement and laws of the state, and by international law. Such agreements entered into are to be observed in good faith. They can, however, be abrogated by nationalization, expropriation and requisitioning based on grounds of public utility, security or the national interest, which are recognized as over-riding purely individual or private interests, both domestic and foreign.

---

[22] Some commentators have raised problems connected with the interpretation of the phrase "peoples and nations" in the resolution and draw a dichotomy between "peoples" and "state". O'Keefe, for example, asserts that the implications of adopting any interpretation of the Resolution which emphasizes the right of "peoples and nations" as opposed to those exercised in the interests of "States" is awesome. He concludes that ultimately, the question must become one of morality in the context of the basic purpose of the State. See for example, O'Keefe P.J., supra n.16, at pp.245-48; Verzijl J.H.W., International Law in Historical Perspective (1968) at p.322; It would appear however, that the U.N. Declarations spoke of the "sovereignty of peoples and nations" at the time when most states were still under colonial hegemony. The phrase would therefore cover the case of non-self governing territories which would not be covered by any concept of the sovereignty of states over natural resources. See, Gess K.N., supra n.17, at p.446.

[23] We shall examine the effect of changed circumstances on "frozen clauses" and the right to renegotiate when dealing with special legal issues related to International Petroleum Agreements in chapter five.

The most significant aspect of this resolution lies in the fact that it lays down some criteria by which legal arrangements for exploitation of natural resources may be tested. The exercise of the right of permanent sovereignty must be in the interest of national development and for the welfare of its nationals. Contractual arrangements for the development of natural resources must conf[illegible]m to rules and conditions which the peoples and nations voluntarily consider to be necessary and desirable.[24] Furthermore, the capital imported and earnings on the capital as already noted are to be governed by the contractual arrangement, national legislation in force, and by international law. The profits accruing therefrom must be divided in the proportions freely agreed upon by the parties. In each case, care is to be taken to ensure that there is no impairment of any of the State's sovereignty over its natural wealth and resources.[25] Also, the legal arrangement between the foreign investor and the host government must be one that would further independent national development based upon respect for the sovereignty over the HCs natural wealth and resources.[26] Lastly, only those agreements which are freely entered into are to be observed in good faith.[27]

---

[24] Hossain K., ed., Legal Aspects of the New International Economic Order (1980), 33 at p.38.

[25] Ibid.

[26] Id.,at p.39.

This resolution was reaffirmed in others which have served to further elucidate the dimensions of the principle of permanent sovereignty. Notable among these[28] is resolution 2158 (XXI) of November 25, 1966. This recognises the fact that foreign investment under proper governmental supervision can play an important part in the development of a country's natural resources. It goes on further to affirm that the exploitation of natural resources in each country "shall always be conducted in accordance with national laws and regulations."[29] Thus, natural resource development agreements and disputes arising therefrom have been subjected entirely to local laws and regulations. A clear omission here, in contradistinction to resolution 1803,is that no references are made to the principles of international law. This implies that in the event of nationalization, the expropriating state is entitled to determine the quantum of compensation and the mode of payment.[30] Any disputes that may arise are to be settled in accordance with the national legislation of the state.[31] It has been noted that resolution 2158 marks the translation of the abstract principles of permanent sovereignty into:

> "precise demands such as increased participation by developing countries in the administration of foreign owned enterprises, a greater

---

[27] See, Para.8 of G.A. Res.1803 (XVII).

[28] See also, G.A. Res. 2386 (XXIII),19 November 1968; 2629 (XXV) of 11 December,1970; 3016 (XXVII), 18 December 1972; 3171 (XXVIII), 17 December 1973.

[29] Para.4 of G.A.Res. 2158 (XXI).

[30] Onejeme A.N., "The Law of Natural Resources Development: Agreements between Developing Countries and Foreign Investors" (1977) 5 Syracuse Journal of International Law and Commerce 1 at p.5.

[31] See also Para.3 of G.A. Res. 3171 (XXVIII).

> share of advantage, and profits of such enterprises, and proper accelerated training of national personnel at all levels and in all fields of the enterprise."[32]

The second phase thus began the appropriate linkage between the concept of permanent sovereignty and the need for adopting a development strategy based on broad pragmatic goals; a gradual foundation of the call for a new international economic order (NIEO) was being laid.[33]

The gradual evolution of the concept of permanent sovereignty and the process of adjustment to new realities marked a formulation of claims expressed in terms of a NIEO. In 1972 a group of developing countries, the Group of 77, proposed to the third United Nations Conference on Trade and Development (UNCTAD) to draw up a "charter of economic duties and rights of states."[34] It was the Group's conviction that the existing conditions that governed international trade relations and policies were no longer adequate to secure the development objectives of the world economy, and particularly their own economies.[35] Thus some action was needed to be taken on this matter. At its meeting in Santiago, Chile, the UNCTAD subsequently adopted a decision on the urgent 'establishment of generally acceptable norms for a systematic restructuring of international economic relations.'[36] It further recognized that 'until implementation of a charter on the protection of rights of all states, in particular developing countries, it will not be possible to establish a more equitable order and more stable world.'[37] These objectives paved the way for adoption at the Sixth Special Session of the GA of two resolutions: the Declaration on the Establishment of a New International Economic Order[38] and a Programme of Action[39] for its establishment and implementation.

---

[32] Supra n.2, at p.31.

[33] Supra n.20, at p.4.

[34] See 3 UNCTAD, 1 Proceedings of the United Nations Conference on Trade and Development para.209, at p. 235. U.N.Doc. TD/180, Vol.1 (1972).

[35] Ibid.

[36] See, UNCTAD Res.45 (111),18 May 1972.

These declarations affirmed the crucial role of natural resources, and the way in which they ought to be developed and disposed of for the benefit of the developing countries and in the interests of the world community at large. It is to be noted that this GA resolution encompassed not only natural resources, but also extended to all economic activity. Finally, in December 1974, the GA adopted the Charter of Economic Rights and Duties of States.[40] In the preamble to the Charter the GA declared: 'it is a fundamental purpose of this Charter to promote the establishment of the New International Economic Order, based on equity, sovereign equality, common interest and co-operation among States irrespective of their economic and social systems'. In the area of natural resource development Articles 1 and 2 provide as follows:

---

[37] Ibid. Also, at the Fourth Conference of non-aligned countries held in Algiers from 5-10 September 1973, the Heads of State or Governments of Non-aligned Countries recommended that the U.N. General Assembly give priority to drafting a Charter of Economic Rights and Duties of States that should reflect "the aspirations of States engaged in the struggle for promoting their own development, as well as the aspirations of the international community as a whole." Cited in Bulajic M., "Rights and Duties of States" in supra n.24, 44 at p.46.

[38] See, G.A. Res.3201 (S-VI), 1974.

[39] See, G.A.Res. 3202 (S-VI0), 1974. The Programme of Action spells out specific areas where re-structuring of relations on the basis of equity is called for. These include:
i) the fundamental problems of raw materials and primary commodities as related to trade and development;
ii) the international monetary system and financing of development in developing countries;
iii) industrialisation;
iv) the transfer of technology;
v) the regulation and control over the activities of transnational corporations;
vi) the matters covered by the Charter of Economic Rights and Duties;
vii) promotion of co-operation among developing countries;
viii) assistance in the exercise of permanent sovereignty over natural resources;
ix) strengthening the role of the U.N.system in the field of international economic co-operation;
x) matters related to the special programme of the U.N.

[40] G.A. Res. 3281 (XXIX).

> 1. Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its natural wealth, natural resources and economic activities.
> 2. Each State has the right:
> (a) To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No State shall be compelled to grant preferential treatment to foreign investment;
> (b) To regulate and supervise the activities of transnational corporations within its national jurisdiction and to take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. Transnational corporations shall not intervene in the internal affairs of a host State. Every State should, with full regard for its sovereign rights, co-operate with other States in the exercise of the rights set forth in this subparagraph;
> (c) To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to controversy, it shall be settled under the domestic law of the nationalizing State and its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.[41]

The Charter thus seeks to stress the sovereignty of states over their natural resources by further elucidating the laws of Host States and policies over foreign investment in natural resource development and over disputes arising from such investments.[42]

---

[41] 29 U.N.GAOL,Supp.(No.31) at p.52.

[42] For a detailed study of the legal aspects of the Charter and the New International Economic Order generally see for example, Hossain K., ed., supra n.24; Makarczyk J., Principles of A New International Economic Order (1988); Meagher R.F., An International Redistribution of Wealth and

For our purposes it is sufficient to say at this juncture that, for developing countries, the principle of permanent sovereignty and the call for an NIEO have been very important. The realization of the goals enshrined in these principles, however,should be one that "calls for courageous initiatives, new concrete and global solutions"[43] directed at solving the present day economic problems, and creating a balance in international economic relations between developing and developed countries. The guidelines provided in the various UN declarations have been manifestly evident in the gradual evolution of national legislation and various contractual forms to meet changing circumstances and national aspirations with regard to petroleum development. As we saw in the first chapter, economic nationalism marked the demise of the traditional concession form of arrangement for petroleum exploration and exploitation, giving way to new forms of arrangements. However, the dynamic potential for change has not been exhausted.

We will now look at the extent to which the doctrinal aspects of the principle of permanent sovereignty has influenced the creation of institutions and the legislative approach to enhance co-operation and accelerated development of the petroleum sector in developing countries.

3. Institutional Framework:

a. National Oil Companies in Developing Countries

A difficulty which investors face in their dealings with HCs is that there is often no central institution to which they relate. An investor often has to negotiate

---

Power - A Study of the Charter of Economic Rights and Duties of States (1979); Hossain K., & Chowdhury S.R.,eds, supra n.4.

[43] See, Bulajic M., "Legal Aspects of the New International Economic Order", in supra n.24, at p.47.

for an exploration licence with one institution and negotiate for financial terms covering the operations with another - often passing numerous barriers to obtain permits from several ministries. The lack of co-ordination amongst the institutions with which the investor deals often results in frustration given the complexity of foreign investment arrangements. Also, negotiators of petroleum agreements require expertise which can best be developed with one institution specifically charged with that responsibility. To ensure proper co-ordination of activities in the petroleum sector therefore, the task of establishing a clearly identifiable institution(s) responsible for oil operations is necessary. To ensure the protection of HC interests, the mechanism of state participation has taken the form of the establishment of NOCs.

Our main concern here will be to look at the form, structure, accountability and control of the NOC as well as its role in petroleum development in developing countries. The role of the NOC and the reasons for its establishment, apart from that noted above, varies from country to country.

The early growth of these companies appear to be traceable to South America and Western Europe with the formation of Yacimientos Petroliferos Fiscales (YPF) in 1922 by Argentina. In Italy, Agip was formed in 1926 and was later absorbed by ENI in 1953. Nationalisation of the foreign oil companies in Mexico, saw the establishment of Petroleos Mexicanos (Pemex) in 1938. In the same vein, the National Iranian Oil Company (NIOC) was established after the nationalisation of the Anglo-American Oil Company in 1951. The trend towards establishment of NOCs achieved an overwhelming momentum with the changes in the world energy situation witnessed during the 1970s. Towards the end of 1977, over some 80 state petroleum enterprises with hundreds of subsidiary and associated enterprises were operating in developing countries.[44] Today, the NOC has become the norm in most developing countries. The immediate factors that motivated these countries, especially the oil importing developing countries,to establish their NOCs was the direct result of pressures that came from the demand oil imports made on foreign exchange, and the conviction that IOCs were placing an unreasonable burden on them in terms of the cost of oil itself and the logistics of supply. The oil importing developing country governments had no real knowledge regarding the import terms or transfer prices of oil nor the practices of the supplying countries' governments. Therefore, NOCs were seen as a "window on the industry" and a source of expertise in international oil development.[45]

i. Form:

An NOC or state petroleum enterprise is defined as:

> an artificial legal person created by an act of the legislature or by government decree; an entity, that is a thing having real existence, and acting on its own volition; responsible, that is accountable, and able to sue or be sued in its own right; a corporation sole, or, less frequently, a corporation aggregate; self-perpetuating, having a continuous existence irrespective of that of its members; autonomous, but not sovereign".[46]

---

[44] Charalambos C.,"State Petroleum Enterprises in Developing Countries" (1978) 3 Natural Resources Forum at p.73.

[45] Bell J., "National Oil Companies:Quo Vadis? The need for National Oil Companies and their Relationship to Government and Industry" (1981) 1 Energy Law 31 at pp.37-38.

[46] Alleyne D.H., "Financial Provisions of State Petroleum Enterprises in Developing Countries" in U.N., ed., State Petroleum Enterprises in Developing Countries (1980) at p.151.

Thus an NOC is a body corporate which has perpetual succession and may sue or be sued in its corporate name. It may, for the purpose of carrying out of its objects, acquire, hold and dispose of movable and immovable property and may enter into any contract or other transactions. There are basically two types of NOCs: 1) joint stock companies controlled completely or partly by the state; 2) public corporations. The use of the joint stock company as an instrument of state participation is mostly common in developed countries, for example, Austria, Finland, Greece and Sweden. In the developing countries, the commercial company has not been widely used. The National Iranian Oil Company (NIOC) and the old Kuwait National Petroleum Company (KNPC) offer examples of this particular form, where the companies are enjoined to carry out operations in accordance with provisions of the statutes creating them and the commercial law of their respective countries.[47] The second type of NOC which is the most prevalent shall be the subject of our discussion, because it is the organisation of choice in the developing world.

The NOC can operate in an environment where a country's entire oil industry has been nationalised or in a mixed economy where the NOC operates alongside the private sector. They possess certain common characteristics, in spite of the diversity of their backgrounds, and their economic and political objectives which include the following:

1. they are created by a statutory instrument;
2. they have a separate legal personality;
3. their day to day administration is entrusted to the hands of a governing body

---

[47] Zakariya H.S., "State Petroleum Companies" (1978) 12 Journal of World Trade Law 481 at p.488.

appointed by the government;

4. their employees are not civil servants;

5. the basis of their assets is not parliamentary appropriation but permanent revenue earning assets (some of them, with the approval of the minister can raise loans; they have to balance revenue and expenditure and any profits made have to be ploughed back in the development of the enterprise; they are commercially audited);

6. they are responsible to government through the appropriate minister and are subject to his general direction;

7. they are private legal entities and are fully liable in law; They do not enjoy any of the legal privileges and immunities of government. Public corporations are said to have a dual nature. Their commercial and managerial aspects are akin to commercial companies since they have an essentially private law status. In the fulfilment of their public tasks on behalf of government, however, they are public authorities and are subject to governmental control, within the limits defined by statute.[48]

NOCs in developing countries were modelled on the established examples of the developed countries, and therefore assume with notable exceptions most of the characteristics just noted above.[49]

ii. Objectives and Powers:

The main objective of the NOC is the promotion of an optimum search for and development of petroleum resources. In this connection, it may be given a completely broad range of power involving petroleum and related activities or just skeletal powers.[50] It is the arm of the state entrusted with fully implementing the overall petroleum policy. It serves as a vital link between the government and foreign companies operating within the national jurisdiction.

---

[48] See, Friedmann W., "A Theory of Public Industrial Enterprise", in Hansen A.H., ed., Public Enterprise - A Study of its Organization and Management in Various Countries (1980) at p.151.

[49] Supra n.47, at pp.489-490. Some examples of national oil companies in developed countries are Petro-Canada, British National Oil Corporation, and Statoil of Norway.

The NOC enables the country to acquire the necessary direct experience in all sectors of the oil industry and to promote the creation of an independent integrated national industry. To this end, the NOC may contribute to the integration of the oil industry in the national economy which may act as a catalyst towards achieving the industrialisation goals of the country. Thus for the purpose of carrying out its objectives, the Ghana National Petroleum Corporation Law, 1983, for example, gives the Ghana National Petroleum Corporation (GNPC) the following powers:

1. to undertake the exploration, development, production, and disposal of petroleum;
2. to promote the exploration and the orderly and planned development of the petroleum resources of Ghana;
3. to obtain the effective transfer to Ghana of appropriate technology relating to petroleum operations;
4. to ensure the training of citizens of Ghana and the development of national capabilities in all aspects of petroleum operations; and
5. to enter into petroleum exploration and production agreements and other petroleum contracts providing for the assistance, participation or co-operation of

---

[50] **Khan I.F.,"National Oil Companies: Form, Structure, Accountability and Control" in Petroleum Resources and Development: Economic, Legal and Policy Issues for Developing Countries(1987) 185 at p.187.**

contractors in connection with petroleum operations.[51] The object of the NOC as exemplified by the GNPC is to encourage state participation which allows for assumption of local control of the oil sector.

iii. Structure and Administration:

The structure and administration of the NOC is a paramount factor in determining its successful operation. The structure of the NOC may vary from one country to another. In the Arab OPEC countries for example, there is a hierarchical structure at the head of which is a Minister or a top ranking official of the Board of Directors. The NOC is attached to a government ministry, with its overall supervision and direction exercised by a Council of Ministers.[52] This Council establishes the general oil policy of the NOC. The Minister responsible for Petroleum or chairman of the board (where the minister is not the head) may make proposals to it, while the board remains responsible for management and administration of the NOC. There is therefore a rigid supervision over the NOC by government.[53]

In the non-OPEC developing countries, the NOC is usually staffed by experts from outside the Civil Service. The government is advised by a national energy body which formulates policy and outlines the operations of the NOC.[54] The NOC itself is run by a Board of Directors which is its governing body. This body is normally constituted by government appointees. For example, under the Ghana National Petroleum Law, the board of directors of the Ghana National Petroleum Corporation (GNPC) consist of six members appointed by the Government on the advice of the Secretary for Fuel and Power. Members of the board, however, represent a cross section of interests - all knowledgeable in one or other aspects of the operation of the oil industry. The Mexican example is worthy of emulation by other developing countries. In that country, the NOC (Pemex), has eleven directors five of whom are appointed by the Oil Workers' Union.[55] This is a recognition of the rights of the worker and may be advantageous in facilitating collective bargaining.[56]

---

[51] Section 2 of the Ghana National Petroleum Law 1983 (P.N.D.C.L. 64).

[52] Supra n.50, at p.188.

[53] Id., at p.189.

[54] In Ghana, for example, there is established a National Energy Board, the functions of which include inter alia, 1. the formulation and recommendations of overall policy on energy to the governing Provisional National Defence Council (P.N.D.C.); 2. monitoring the operations of public bodies with responsibilities for the regulation and management of energy development and utilization of national energy resources in terms of the policies of the P.N.D.C. See, section 2 of the National Energy Board Law 1983 (P.N.D.C.L 62).

Under the non-OPEC model the board is usually responsible for the actual management of the NOC and it is supposed to be independent and autonomous from governmental interference. In some Arab OPEC countries the NOC is governed by a semi independent board of directors. However, in Saudi Arabia for example, the board is the authority that controls the affairs of the NOC and in the conduct of its business lays down the general policy to be followed. It is not bound by the administrative and financial regulations applicable to government departments.[57] It is to be noted that even though the NOC is supposed to be autonomous and independent in the carrying out of its duties, it must normally operate within the broad policy guidelines issued by the government. In Abu Dhabi, another Arab OPEC country for example, Abu Dhabi National Oil Company is empowered to carry out its activities in accordance with customary commercial practices, in so doing it must adhere to the general oil policy of the state.[58]

---

[55] Supra n.50, at p.189.

[56] Ibid.

[57] Iraq also exemplifies an exception to the Arab OPEC model. In that country, the management and attainment of the objectives of the Iraq National Oil Company (INOC) is undertaken by a financially and administratively independent board of directors. See Article XI of Law No. 123 (1967) of Iraq quoted in Zakariya H.S., "State Petroleum Enterprises: Their Rationale, Legal Structure, Management and Jurisdiction" in supra n.46, at p.37.

iv. Accountability and Control:

A NOC is an arm of the state which creates it and owns its entire capital. Though it must enjoy some financial and administrative independence to fulfil its objectives, it is also recognized as important that its activities be subject to scrutiny and control by the state.[59] As noted earlier,it must operate within its constituent instrument and abide by rules of financial accountability, budgeting and auditing to which all other government enterprises are subjected. Accountability aims at reviewing the decision-making and profitability of the NOC in the public interest.[60]

State control of the NOC assumes different forms. One such source of control is ministerial supervision. The minister usually has control over appointments to the management board, budget and borrowing, and a supervisory role. Under the Ghana National Petroleum Corporation Law, the Secretary for Fuel and Power advises the government on the appointment and removal of members of the Board of Directors of the GNPC. Additionally, the power of the GNPC to borrow money is exercisable only on the recommendation of the secretary and with the approval of the secretary responsible for finance. Such matters as the terms and conditions of borrowing, including furnishing information as to the amount, source of the loan and the conditions under which it may be contracted require secretarial approval.[61] Other forms of control include the approval of the secretary for acts of the GNPC relating to the entry into petroleum exploration and production agreements; adoption of long-term plans and annual budgets, and the annual balance sheet and statement of accounts of the corporation.[62] In Venezuela, the statute of the Venezuelan Petroleum Corporation (CVP) of 1966 requires the submission of certain decisions, for example, the annual budget of the company to the council of ministers for approval before they become effective. Similarly, in Abu Dhabi, decisions of the company's board of administration concerning involvement of the company in exploration and drilling for petroleum, or establishment of companies on its own, or in association with others must be submitted and approved by the council of ministers before they can be valid.[63]

---

[58] For details on the operation of the Abu Dhabi National Oil Company, see Suleiman A., "National Oil Companies - Quo Vadis ? The Abu Dhabi National Oil Company" supra n.45, at pp.103-133: see also, Taher A.H., "The Role of State Petroleum Enterprises in Developing Countries: The Case of Saudi Arabia" in supra n.46, at pp.23-27.

[59] Supra n.47, at p.491.

[60] Supra n.50, at p.191.

These examples serve to illustrate the link between the board of directors or management and the minister responsible for petroleum or the government representative. Control provisions are designed to ensure that no important decisions by the NOC are made without a full examination of the socio-economic or political implications for the nation. This is also particularly significant not only to "ensure that the ...[NOC] .. is faithfully adhering to the policy directives of government, but also that it is not transgressing the limits of its jurisdiction as laid down in its statute and other applicable laws".[64] At the same time, it is also important that government, having enunciated its national objectives and policies, must give the NOC a free hand to operate within that framework. Frequent interaction between ministerial and company heads should serve as a forum for exchange of views and information. Sterile and restrictive statutory and administrative provisions must be eliminated.[65] It is submitted that maintaining a balance between autonomy and control of the operations of the NOC is really difficult to achieve in practice. Nevertheless, a well organised and independent NOC with properly defined guidelines and financial support by the state, can be an effective instrument in accelerating petroleum resource development in developing countries.[66]

---

[61] See, supra n.51, at section 15.

[62] Id., at section 24.

[63] Supra n.47, at p.494.

Today, NOCs appear to have been quite effective in the petroleum development of HCs. Their increasing role in supervising exploration and production programs under oil contracts with IOCs is remarkable. An important objective of HCs is to break the stranglehold on over-reliance on imported oil. NOCs have thus become vehicles for the fulfilment of the domestic oil consumption needs of the HC. Also, they have tried to maximize oil revenue for the HC through the fiscal regime of the oil operations in which they are involved. However, their impact has not been felt as instruments for the development of local expertise.[67] It is suggested that greater emphasis be placed on the establishment of training schools as well as on-the-job training to serve as a pool for the achievement of the domestic manpower needs of the HC.

---

[64] Id.,at pp.491-492.

[65] Supra n.46, at p.171.

[66] Ghadar F., Petroleum Investment in Developing Countries (1982) at p.33.

[67] U.N.C.T.C., Main Features and Trends in Petroleum and Mining Agreements (1983) at p.47.

v. Judicial Control:

Another form of control exercised over the NOC is that of judicial control. Normally, a public corporation that is identifiable with Government is referred to as a servant of the state or state instrumentality. It may be given a title which does not reflect the legal realities. Whether or not a corporation is an agent or servant of the state so as to share in its immunities and privileges, or an independent public corporation depends upon the statutory instrument creating it. It may also depend upon the nature and degree of control exercised by government over the corporation which the courts will be prepared to accept as being sufficient to make the corporation an agent of the government. It may also depend upon whether the functions of the corporation are sovereign in nature. NOCs are usually exempted from customs duties, taxes and charges on materials, machinery or equipment imported for the purpose of carrying out its operations for the benefit of the state. In the absence of express provision granting it certain immunities or privileges, it may be amenable to the ordinary laws of the land just as any other corporation.

For our present purposes we shall examine the issue of whether a corporation is a servant of the state from the perspective of English common law. The discussion will thus be largely relevant to Commonwealth countries. This is particularly important in determining what, if any, governmental immunities and privileges are available to the NOC.

The fact that a corporation serves a public purpose, uses public funds or assets and is subject to some degree of control imposed by Government may not necessarily make it in legal terms, a servant of the state. Depending on the nature of the particular corporation, it may sue or be sued in its corporate name, and may be responsible for crime, or in tort and contract, for any wrongful acts of its servants. In the English case of Tamlin v.Hannaford,[68] it was held that, the British Transport Commission established by the U.K. Transport Act 1947, was not a servant or agent of the Government even though it was controlled by a government department. Lord Denning stated that:

> "In the eye of the law, the corporation is its own master and is answerable as fully as any other person or corporation. It is not the Crown and has none of the immunities or privileges of the Crown. Its servants are not civil servants, and its property is not Crown property. It is as much bound by Acts of Parliament as any other subject of the King. It is, of course, a public authority and its purposes, no doubt, are public purposes, but it is not a government department nor do its powers fall within the province of government.... .....When Parliament intends that a new corporation should act on behalf of the Crown,it as a rule, says so expressly...."[69]

The principle formulated in this case does not pose problems where the legislature expressly states that a particular corporation should be a government instrumentality. In cases where the enabling statute is silent on this, the function of the courts will be to determine, by resort to rules of statutory construction, whether the legislature intended that a particular corporation should be the servant of the government.[70]

---

[68] [1950] 1 K.B. 18.

[69] Id., at pp.24,25.

In English law the courts have generally looked at the relationship between the Government and a statutory corporation in the determination of whether or not a particular corporation is a state instrumentality. As stated earlier, the various tests used as aids in this determination are as follows: a) Whether the statutory body has any discretion of its own; if it has, what is the degree of control by the Executive over the exercise of that discretion; b) whether the property vested in the corporation is held by it for and on behalf of the Government; c) Whether the corporation has any financial autonomy; d) Whether the functions of the corporation are governmental.[71] It is not intended to discuss the scope of these tests.[72] Their application one way or the other will tend to establish whether or not a particular oil company is an agent of the government. The only comment that would be made here is the caution that must be exercised in the application of the fourth test, especially in developing countries. The courts have for a long time been unwilling to treat public corporations performing commercial, industrial or trading activities as state instrumentalities.[73] The increasing role of governments directed at economic development has made strict adherence to this doctrine impractical.[74] Today, governments have ventured out of their "traditional role" to fulfil ever-increasing normal functions of a predominantly social and economic nature".[75]

---

[70] For a detailed discussion on the judicial control of the NOC, see, McCall J.K., "Legal aspects of doing business with National Oil Companies" in International Bar Association ed., Energy Law in Asia and the Pacific (1982) at pp.305-329. See also for a case-study on the legal control of the Malaysian National Oil Corporation, Moorthy V.K., "The Malaysian National Oil Corporation - Is it a Government Instrumentality" (1981) 30 International and Comparative Law Quarterly at pp.638-659.

[71] For a detailed discussion of the various tests used by the common law courts see for example, Griffith J.A.G., "Public Corporations as Crown Servants" (1952) 9 University of Toronto Law Journal 169; Hogg P.W., Liability of the Crown (1971) at pp.204-214.

[72] See, ibid.

[73] Moorthy V.K., supra n.70, at p.652.

The practical considerations involved in treating a particular oil company, especially in a developing country, as a state instrumentality are not difficult to find. Petroleum resources in these countries are vested in the state on behalf of its citizens. Governments therefore tend to assign these resources to a corporation that is subject to the control of government. Also, the tendency towards increasing state participation in the exploitation of oil resources, coupled with the desire to control the IOCs are sufficient indicators in treating an oil company as a state instrumentality.[76]

Judicial control of the public corporation is exercised through the ultra vires doctrine. That is to say that the courts will declare an act of the corporation as invalid and contrary to law if it exceeds its objects or powers. The role of the courts in some developing countries has been rather made difficult in this regard since the company's primary responsibility is to parliament.[77] The courts may also sometimes appear unwilling to review actions of an NOC where a minister gives 'directions in the public interest' for fear that it may encroach on the domain of parliament or on the executive power.[78]

---

[74] Ibid.

[75] Supra n.47, at p.487.

[76] Moorthy V.K., supra n.70, at p.659

[77] Supra n.50, at p.192.

[78] Ibid.

It is submitted that the courts must be bold in pronouncing the acts of an NOC as ultra vires if it exceeds its objects. The adoption of a judicial policy in this direction will ensure that the NOC is at all times acting in the interest of the state. It will also make the NOC wary that its acts will be reviewed if it goes beyond the objects for which it was set up. The considerations just noted should not be difficult in their application to majority of NOCs we have described outside of Commonwealth countries. It is suggested that some form of judicial control even with the largely independent NOCs is desirable to ensure that the NOC does not totally deviate from the purposes for which it was set up.

vi. Role of National Oil Companies in Developing Countries:

An assessment of the performance of NOCs is a rather difficult undertaking. This is because measuring their performance by their commercial profitability alone is not enough.[79] Each NOC is an expression of the of the opportunities, problems and petroleum policy goals of the particular country concerned. NOCs through their operations provide government with a better understanding of the oil industry so that government can discharge its broader policy responsibilities with greater awareness and effectiveness.

To mention a few examples, most of the NOCs have been granted a wide range of functions. The older and more established companies have engaged in not only the normal stages of the development of petroleum resources but have extended their activities to transportation, storage, refining, trade, distribution, and the petrochemical industry.[80] These activities have been carried out with varying degrees of success, both at the domestic level and outside their home countries. Petrobras of Brazil, provides an example of the diverse roles played by NOCs. It has carried out exploration ventures in Iran, Libya, Algeria and Angola.[81] The Oil and Natural Gas Commission of India (ONGC), has undertaken operations in Iran, Syria, and Tanzania; the National Iranian Oil Company (NIOC) in the North Sea; and Yaciementos Petroliferos Fiscale (YPF) of Argentina in Uruguay.[82] Other forms of activities include the involvement of the NOCs in partnership with IOCs to develop the petroleum resources of the countries concerned. The Egyptian General Petroleum Corporation (EGPC) has had a long, successful record of exploration in partnership with IOCs under different types of agreements.[83] The Malaysian State Petroleum Company, Petrolian Nasional Berhand (Petronas), has been instrumental in the major achievement of converting existing concessions in Malaysia into production-sharing contracts.[84]

---

[79] Megateli A., Investment Policies of National Oil Companies (1980), at p.22. For details on the criteria for the measurement of state corporation performance, see, Pozen R., Legal Choices for State Enterprises in the Third World (1976) at pp.22-46.

In the field of refining, some of the exporting countries are co-operating with importing countries in the establishment of market and intermediate refineries.[85] The growing importance of NOCs in crude oil trading and the growing bargaining power of the bigger ones may mean that non-commercial criteria, such as political factors, may prevail over market forces in the allocation of oil supplies.[86] It has been suggested that these activities of co-operation between the larger well established and the smaller NOCs *of developing countries is sometimes* related to a search for sources of supply for the companies' home countries, while in other cases, it is an effort to put technological capabilities to full use.[87] However, such co-operative efforts should be encouraged, since they offer another option for developing countries to develop their petroleum sector.

---

[80] Supra n.47, at p.497.

[81] Supra n.67, at p.48.

[82] Supra n.47, at p.497.

[83] Id., at p.486.

[84] Id., at pp.486-487.

[85] See, Alleyne D.H.N., "Possibilities and Opportunities for Co-operation among Developing Countries in Petroleum Refining" in U.N. ed., Petroleum Co-operation among Developing Countries (1977) 56 at p.59.

The role of the smaller, and more recently established NOCs has been confined to domestic marketing or to small-scale refining based on purchased imported crude. These companies provide petroleum products at low prices for internal consumption. They perform these functions as a means of reducing dependence on IOCs and to control the domestic distribution of oil products. Government assistance to the companies has taken the form of obtaining for the companies secure supplies at the best available terms.[88] In cases where private companies undertake domestic marketing and distribution of petroleum products, the NOCs' role has been that of controlling or supervising such activities within the national boundary.

In sum, it should be reiterated that, whereas the NOCs have operated both within and (in the case of the larger companies) outside their national boundaries with varying degrees of success, there is still more yet to be done. Petroleum development should not be undertaken in isolation but should be viewed in terms of a global long-range policy for the country.[89] Apart from the broad national objectives set out in their constituent instruments, comprehensive long term strategies must aim at developing the necessary human resources. Investment planning must be carefully conducted and this should help in deciding on a wide range of policy choices and among numerous investment alternatives within the petroleum industry.[90]

---

[86] Supra n.67, at p.48.

[87] U.N.C.T.C., Alternative Arrangements for Petroleum Development (1983) at p.10.

[88] Mafi-Nazem M., "Co-operation Among State Petroleum Enterprises" in supra n.46, 61 at p.62.

Finally, it is submitted that some form of governmental control should be maintained over the NOCs. This is desirable given the fact that NOCs were established as an expedient way of accomplishing national goals, and to have a domestic focus in an international industry. To ensure that they are carrying out objectives sought to be achieved through state participation in petroleum development, their operations should reflect what the government wants from time to time.

At the other end of the spectrum it is necessary that the NOC be given a free hand to operate without undue interference which might hinder the realization of those objectives. There must be a way of reconciling national and commercial objectives.

Government could exercise control by its appointment to the board of directors of the NOC as well as laying down general policy guidelines. Once this is done the

---

[89] Megateli A., supra n.79, at p.201.

[90] Ibid.

NOC within that framework should be left to carry out its day-to-day activities taking into account the dictates of normal commercial practice.

In the words of Zakariya, "this dialectical interaction between the two opposing needs -autonomy and control- can sometimes be very difficult to regulate in practice".[91] The appropriate balance to be maintained should, however, differ from one situation to another.

4. Legislative Framework:

The importance of petroleum legislation as an instrument for securing the host state's petroleum development cannot be overemphasised. The most basic issue in this context is how to strike a balance between using laws as a mechanism capable of attracting the necessary foreign investment on one hand and, on the other, structuring the host state's laws without gradually bargaining away its economic independence. The trend towards enacting comprehensive domestic laws by developing countries is indicative of their realisation of the need to provide a basic legal framework within which to negotiate petroleum development contracts with foreign oil companies. There are different ways in which the legitimate objectives of the host government and the investor can be accommodated within an appropriate legal framework. Against this background, an attempt will be made to examine broadly some general aspects of the types of legislative systems available in developing countries, and their relative merits and demerits in the promotion of petroleum development.

Broadly speaking, there are three types of legislative systems which are discernible from the petroleum laws of developing countries. These are:

---

[91] Supra n.47, at p.492.

a) fixed or general legislative system;

b) flexible or hybrid legislative system; and

c) agreement system.

Under the fixed legislative system, the law stipulates in advance the conditions and terms which govern rights of exploration and exploitation of petroleum resources. These rights may be granted under standard form licences or leases. Financial provisions, such as royalties, taxes and other payments are also determined by legislation. Thus under this system, a comprehensive and detailed description of the respective rights and duties of the parties are determined beforehand. Every conceivable issue that may arise in the course of operations is covered in precise detail. This legislation may contain all or most of the provisions that are found in the different types of international petroleum agreements.[92] Examples of countries where this system operates include developed countries like the United States, Australia, Canada and most members of the European Economic Community. In the developing countries, most of the Latin American countries and Libya[93] offer examples of this system of legislation.

The relative advantage of this system over the others is that it gives the assurance of equal treatment to all licensees and is simple to administer.[94] The HC may have a stronger bargaining position since the impression may be given that terms and conditions that an IOC may be prepared to accept are not negotiable. Additionally, the inclusion of major provisions into a petroleum law introduces a measure of stability and predictability to the relationship between host government and oil company given the risky nature of the international oil business.[95]

---

[92] Some individual terms of a contract may be left for negotiation under this system. See Blinn K.W. et al., International Petroleum Exploration and Exploitation Agreements -Legal, Economic and Policy Aspects (1986) at p.34.

[93] For a detailed analysis of the Petroleum Law No.25, 1955 which is the governing legislation in Libya, see, Al-Qasem A., Principles of Petroleum Legislation -The Case of a Developing Country (1985).

[94] Supra n.87, at p.58.

Another merit of the general legislative system is that it can be used to adapt terms and conditions of a petroleum development arrangement to changing conditions.[96] It also allows general policy objectives of the HC to be incorporated in the legal framework. Standards and conditions[97] may be laid down which cover issues such as granting, withdrawal or cancellation of a licence; information as to the technical and financial capabilities and experience of the company; information to be submitted during the various stages of petroleum operations; maximum size of an area which can be awarded to an applicant; duration of the contract; requirement for minimum work and expenditure obligations during exploration; and safety requirements.[98]

---

[95] Moquet A., "Problems Related to the Negotiation of Production-Sharing Contracts" in International Bar Association ed., Energy Law '88 at p.765.

[96] See, Hossain K., Law and Policy in Petroleum Development (1979) at pp.103-104, where he cites examples of Canadian and Indonesian Petroleum legislation being used to bring about certain desired results in response to changes in the environment in the oil industry respectively. Another vivid example of using legislation to review contractual arrangements due to changed circumstances can be found in the Petroleum (Exploration and Production) Law,1984 of Ghana which states in section 13 that: "A petroleum agreement shall provide for a review of its terms at any time any significant changes occurs in the circumstances prevailing at the time of the entry into the agreement or the last review of the agreement".

[97] Law 80-001, 1980 containing the Petroleum Code of Madagascar for example states in Article 11: "The conditions applicable to the granting of a mining concession, to its partial or total transfer and to its withdrawal or cancellation, as well as the particular rights and obligations it entails, its duration and the rules governing its renewal, shall be matters decided by decree of the Council of Ministers". Reproduced in Basic Oil Laws and Concession Contracts - South & Central Africa (Original Texts) Supplement No. LXI (61) at p.15.

The general legislative system is however not without its problems. The general criticism levelled against this approach is its inflexibility. If the terms and conditions set by the HC are too rigid, it could act as a stumbling block to oil companies wishing to embark upon petroleum exploration in the HC. On the other hand, if the terms set are too low, this would be detrimental to the interests of the state,[99] since the effect would be to give away terms unduly favourable to the IOC. It has been suggested that, in order for the HC to attract the necessary investment for exploration, especially in countries without reserves, terms must be set that reflect the country's standing on the oil market.[100] Practically this could be done by leaving some matters to be settled during negotiations, and in appropriate circumstances by granting certain exemptions to the basic standards set in the legislation.[101]

The second type of legislative mechanism is the flexible or hybrid system. Under this system, general legislation lays down fundamental guidelines and sets minimum conditions required prior to the grant of exploration or development contracts. The law however, leaves room for important terms and conditions to be settled by negotiations. The Jamaican Petroleum Code, the Tanzanian Petroleum

---

[98] Supra n.96, at pp.106-107.

[99] Ibid.

[100] Brown R., "The New Petroleum Code in Tanzania - Policy Options for Exploration in a Developing Country", (1981) 1 Energy Law 341 at p.342.

[101] See supra n.96, at p.107.

(Exploration and Production) Act,[102] and the Ghana Petroleum (Exploration and Production) Law offer examples of this system. These laws give broad discretionary power to lay down detailed rules and regulations, but at the same time allow individual adjustment of certain terms.[103]

The merit in this option is its flexibility. It leaves room for the HC to adjust to changing circumstances, without having to submit numerous amendments to the law-making body in the HC.[104] The enabling legislation allows the HC to respond promptly to any new needs which may arise by amending rules and regulations made by virtue of the enabling legislation.[105]

This system insulates the government from pressure and also strengthens its bargaining power since a bottom line is drawn. Negotiations may proceed from the statutory minimum conditions set by government, thus obviating the need to concede to pressures from the oil company to grant it terms more favourable than those set out by statute.[106] Hossain observes that:

---

[102] For a detailed analysis of this approach as applicable to Tanzania, see supra n.100, at pp.341-348.

[103] The basic features of the Ghana Law for example, provides for the validity of a petroleum agreement for a period not exceeding thirty years. This may terminate at an earlier period stipulated in the agreement. The law goes on to make provision for certain broad terms the details of which must be incorporated in an agreement such as: the periodic submission of reports on exploration; the preparation and submission of a time-table to carry out adequate and effective appraisal of a commercial discovery; review of terms and conditions of the agreement; relinquishment of portions of an area to which an agreement relates; minimum work and expenditure obligations; participation interest to be held by the GNPC upon the declaration of a commercial discovery; payment of taxes and royalties; and plans and training programmes for Ghanaians in all aspects of petroleum operations. Apart from these provisions, the Secretary responsible for Fuel and Power has broad discretionary powers to make regulations covering a wide range of issues. These issues include, inter alia, ensuring safe operations and the welfare of persons employed in the industry; pollution prevention and remedial action thereon; keeping and inspection of records and accounts; the rates of royalty payable to the state in respect of petroleum production and the methods of calculation ; and the penalties for offences against the regulations.

[104] Supra n.92, at p.35.

[105] Ibid.

> "[the government] can thus invite companies to submit competitive bids offering terms better than the minimum. [It] can seek improvement of terms through negotiations. In cases where the government is empowered to grant certain exemptions, it can trade off such exemptions against valuable concessions from the company.......[T]he interaction of statutory and contractual terms [thus] provides a framework to play off such inter-relationships".[107]

The agreement system offers the third choice as a legislative mechanism. Under this system, there is no extensive general legislation or where it exists it takes the form of broad enabling legislation[108] that leaves virtually all the terms and conditions to be determined by individually negotiated agreements. This form has been widely used in most of the Middle-Eastern oil producing countries such as Saudi Arabia, Iran, Iraq and Abu Dhabi.[109]

This system offers the HC the maximum flexibility in all aspects of the petroleum development arrangement and especially at the negotiation phase. For the HC to utilise this system to its advantage, it needs to have a clear perception of what it is seeking to achieve under the arrangement. A properly formulated and co-ordinated policy backed by a model agreement setting out the minimum standards and conditions is needed. This should generally indicate the terms or issues that are negotiable and those that it would treat as not negotiable.[110]

---

[106] See supra n.96, at pp.107-108.

[107] Ibid. See also, Walde T., "Lifting the Veil from Transnational Mineral Contracts: A Review of Recent Literature" (1977) 1 Natural Resources Forum 277 at p.279.

[108] Some standard forms are incorporated in the legislation and basic legislative criteria may exist for terms traditionally included in international petroleum agreements. See, supra n.92.

[109] Supra n.66, at p.85.

It has been observed that oil companies have a preference for this system. Once certain contractual commitments are obtained, the HC finds it difficult to change the terms of the agreement after it has been signed. This is particularly marked in situations where certain clauses of the agreement are "frozen" for a fixed duration. An example of this would be a contractual provision that limits the HC's sovereign right to change tax rates from time to time.[111] The HC must ensure that whatever terms are embodied in a contractual arrangement are, as far as possible, well balanced and equitable. It can only fulfil this requirement by having the necessary professional and technical staff to fulfil this task during negotiations.[112]

In sum, it is sufficient to say that, no matter what system is adopted, the subject-matter of national legislation should include certain vital issues such as:

1. Ownership of petroleum resources within the subsoil and the transfer of portions of oil due to the oil company upon extraction from the subsoil;
2. Laws should be promulgated giving rights to the state to be kept informed

---

[110] Date-Bah S.K., & Rahim M., "Promoting Petroleum Exploration and Development: Issues for Government Action" in supra n.50, 93 at p.95.

[111] Supra n.92. Hossain cites an example of this situation under the joint venture agreement of 1957 between the National Iranian Oil Company and AGIP. A clause inserted in this agreement provided that:"No general or special measure, legislative or administrative, or any other act of this kind emanating from the Iranian government, can annul this Agreement, amend or change its provisions, prevent or hold up the necessary and effective execution of these stipulations....The abrogation,amendment or modification of the Agreement shall not take place without the unanimous consent of the parties. In case there is a difference between the provisions of the Agreement and existing laws, the provisions of this agreement shall remain valid". See NIOC-AGIP Joint Venture Agreement dated 24 August 1957,Petroleum Legislation, Concession Contracts, Middle East, Supplement, quoted in Hossain K., supra n.96, at p.104. Another classic example is the Master Agreement of the Volta River Project in Ghana. This agreement executed in 1962, sought to stabilise the fiscal regime and provided, amongst other things, for a fixed price for electric power to be supplied by the Volta River Authority. It was intended to remain unchanged for thirty years.

[112] Ibid.

of the oil company's exploration and exploitation activities;

3. The basic requirements of the oil company's contribution to the domestic consumption needs of the HC;
4. The IOC's obligation as regards training of local personnel in all spheres of petroleum operations;
5. The determination of the duration of exploitation and exploration phases;
6. Taxation issues and the payment of royalties;
7. Guarantees as to the right of the oil company to transfer or assign its rights to a third party which must be made contingent upon the technical and financial capabilities of the third party; and
8. Environmental issues such as the prevention of pollution,ensuring the health, safety and welfare of the workers in the industry.

This list is not meant to be exhaustive of all the issues which must form the subject matter of domestic legislation.[113] It is very important for the HC to realise that, no matter what institutional or legislative mechanism it decides to employ in securing its objectives,there should always be in-built flexibilities to allow for changes in response to changing circumstances.

It should be observed that the fixed or general legislative system is likely to be favourable in countries with good oil prospects. Even though the terms and conditions of the arrangement are determined beforehand by legislation, an IOC that finds such terms unfavourable may decide to go ahead if the oil prospects are very good. For countries with small reserves, the flexible or hybrid system should be preferable. Fundamental guidelines should be set leaving important issues to be settled by negotiation. The appropriateness of this mechanism is found in the best opportunities that it offers when it comes to negotiations. The HC would thus be in a position to determine whatever bargains it wants to strike with the IOC taking into consideration the size of its possible reserves.

---

[113] For a discussion of the issues listed above as well as others, see supra n.95, at pp.765-771.

CHAPTER FOUR

TYPES OF INTERNATIONAL PETROLEUM AGREEMENTS - AN EVALUATION.

Introduction:

In the last chapter an attempt was made to discuss the various institutional and legislative mechanisms set in place in HCs to attract petroleum development. The mechanisms were viewed in the context of the principle of permanent sovereignty over natural resources. In this chapter we shall examine the trends in petroleum contracts between HCs and IOCs. Their main advantages and drawbacks will be considered. This is intended to offer an insight into how contracts can be structured to yield desirable results beneficial to the parties.

It must be stressed from the outset that an attempt will not be made to prescribe which contract form is the best for developing countries since that is a rather difficult task. There are certain dangers involved in that kind of approach. There is the tendency to emulate a particular form of successful arrangement of one country and to adapt it to another country. Given the fact that countries differ in terms of experience in the oil industry, and geological prospects amongst others, terms may be offered which do not reflect the realities in the particular country copying the example of another country. In the event that a HC chooses to follow a particular contractual example, some modifications in contract structure and fiscal terms may yield the desired result. The important factor to bear in mind is that each contract must be adjusted to the particular circumstances in any given situation. A good contractual arrangement will be one that yields the maximum benefit to both parties, allocates risks to the parties capable of bearing them, and ensures stability despite changing conditions.[1] These would seem to address the problems which confront both IOCs and HCs.

2. Concession Agreements:

The concession agreement system was the original system used in world petroleum arrangements. It is still widely used today, although its original form has been completely replaced by a modern version.

2.1. The Original Concession:

Although this contractual system as already noted, has been replaced by the modern concession, it is useful to briefly[2] examine its features since it offers an insight into the evolution of new contractual forms. Basically, a concession:

> "consists...in the granting of certain rights called mineral or mining rights to an individual or an entity authorizing him or it, to explore for and, in case of discovery, to produce and exploit, the mineral(s) object of the concession.Those rights entail the ownership of the mineral(s)....."[3]

The framework within which the concession arrangement was viewed according to Smith, had four elements to it namely;

> "[f]irst, the concession was viewed as a two party agreement between

---

[1] Blitzer C.R. et al., "Oil Exploration in the Developing Countries: Poor Geology or Poor Contracts?" (1985) 9:4 Natural Resources Forum 293 at p.298.

[2] There have been much literature on the original concession. For a more detailed and fuller discussion of this system, see for example, Cattan H., The Evolution of Oil Concessions in the Middle East and North Africa (1967);Cattan H., The Law of Oil Concessions in the Middle East and North Africa (1967); Toriguian S., Legal Aspects of Oil Concessions in the Middle East (1972); Mikesell R., Foreign Investment in the Mineral and Petroleum Industries (1971); Tanzer M., The Political Economy of International Oil and the Underdeveloped Countries (1971); Moran T., "The Evolution of Concession Agreements in Underdeveloped Countries and the U.S. National Interest" (1974) 7 Vanderbilt Journal of Transnational Law, at pp.315-334; Smith D.,& Wells L., Negotiating Third World Mineral Agreements (1975).

[3] Blinn K.W. et al., International Petroleum Exploration and Exploitation Agreements -Legal, Economic and Policy Aspects (1986) at p.55.

> the host country and the concessionaire. Second,it was viewed as a contract in the formal sense.....Third,it was seen as a zero sum arrangement in which one party wins and the other loses on specific issues.Fourth,the old concession analysis was, by and large, isolated from industry structure and from economic analysis."[4]

Turning to an examination of the salient features of the concession one could easily understand why it fell out of favour with the HCs[5] with the passage of time.

Firstly, the area of the concession was very large sometimes covering an entire national territory or the most promising areas of the territory.[6] The IOC was given the exclusive right to explore for, and exploit, petroleum at its own risk and expense, with no provisions for mandatory relinquishment of any part of the concession area. The areas of land granted to the concessionaires were thus larger than they could actually develop within a reasonable period of time. An example of this state of affairs can be found in the concession agreement between the Kuwait Oil Company and His Excellency Sheikh Sir Ahmed al Jabin as Subah dated December 23, 1934.[7] Article 1 of the agreement granted the oil company:

> "the exclusive right to explore, search, drill for, produce and win natural gas, asphalt, ozokerite, crude petroleum.....within the state of Kuwait including all islands and territorial waters appertaining to Kuwait...."

---

[4] Smith D., "Mining the Resources of the Third World: From Concession Agreements to Service Contracts" (1973) 67 American Journal of International Law, 227 at p.228.

[5] See supra, chap. 1, at pp.15-18, where in the context of the history of the world oil industry we briefly discussed the gradual change in the HC-IOC relationship as a result of disapproval with the traditional concession system.

[6] U.N.C.T.C., Alternative Arrangements for Petroleum Development (1982) at p.46.

[7] A consolidated summary of this agreement can be found in Basic Oil Laws and Concession Contracts-Middle East(Original Texts), Vol.2 at pp. A-1 -A11.

The concession generally granted a property interest and was a long term agreement.[8] Its duration typically covered a period between 60 to 75 years and sometimes even up to 99 years. The duration of the Kuwait concession for example, stretched over a period of 75 years. This was later extended for 17 additional years.[9]

The fiscal regime of the concession was limited to the payment of royalties which were computed on the basis of a fixed rate applied to the volume of output, rather than a percentage of the oil produced. To cite an example, a 1949 agreement between Saudi Arabia and Getty Oil provided for a royalty of U.S. 55c per barrel of oil produced and saved.[10]

As far as could be ascertained, the concessionaires' operations were free from all taxation. They also retained virtual control over all aspects of operations such as the rate of exploration, determination of production levels, the setting of prices and the right to transport hydrocarbons which were discovered.[11] Article 7 of the Kuwaiti agreement provided:

> "the company, its operations, income, profits and property including petroleum shall be exempt and free during the period of this Agreement from all present or future harbour duties, export duties, taxes, imposts and charges of any kind whether state or local tolls, and land surface rent of whatever nature....[It] may import/or re-export water,petroleum,machinery,equipment etc.required for operations free

---

[8] Supra n.3, at p.240.

[9] Supra n.7, at p.A-2.

[10] The Getty royalty sounds about 25% of the oil price per barrel in 1949 which seems high. The point being made here is to show payment of a fixed cash royalty rather than the royalty been expressed as a percentage of the export price of crude oil. The financial obligation imposed on the IOC under this system was thus limited. See, Smith D.,& Wells L., supra n.2, at pp.31-32.

[11] Supra n.3, at p.58.

of import or export duty and taxes or other charges....".[12]

By Article 5 of the agreement, the company's rights included the right to "construct and operate power stations, refineries, pipelines, storage tanks, roads,etc. and may use sand, gravel etc. free of payment".[13] Article 9 stated that the company was to enjoy:

> "unrestricted use and occupation of and surface rights over all uncultivated land belonging to the Sheikh which the company may need for the purposes of its operations and in particular the company shall have the right to select in consultation with the sheikh an area or areas of land chosen by the company outside the present town wall of Kuwait with exclusive surface rights upon which to erect oil refineries, storage, terminal and shipping facilities and other works required......"[14]

Lastly there were no provisions under the old concession regime for the alteration, amendment or the possible revision of the terms and conditions of the contract. Thus for example, Article 38 of the agreement between Sapphire Petroleum Limited and the National Iranian Oil Company of 1958 stipulated:

> 1. The Parties undertake to carry out the terms and provisions of this Agreement in accordance with the principles of mutual good will and good faith and to respect the spirit as well as the letter of the said terms and provisions.
> 2. The confirmation of this Agreement by the Council of Ministers as provided for by Article 2 of the Petroleum Act shall be regarded as acceptance by the Iranian Government of all such obligations as by the terms of this Agreement are laid upon the Government, including any acts to be performed or any consents to be given by it.
> 3 No general or special legislation or administrative measures or any other act whatsoever of or emanating from the Government or any governmental authority in Iran(whether central or local) or from [National Iranian Oil Company] shall annul or hinder the due and

---

[12] Supra n.7, at p.A-2.

[13] Id., at p.A-5.

[14] Ibid.

> effective performance of its terms. Such annulment, amendment or modification shall not take place except by the agreement of the Parties.[15]

2.1.a. An Assessment:

The principal advantage of the original concession system was that its administration was relatively easy. The fiscal provisions were straightforward and not complex.[16]

The perils of this system may be briefly summarised. The transfer of ownership of oil to the companies was incompatible with the sovereignty of the HC as owner of the resource. The system gave the HC only a passive and limited role in the development of its resources. The HC had no say in the management of petroleum operations. The oil companies had all the discretion regarding rates of exploration and production over the large expanses of land granted to them. The long duration of the agreements meant that the HC could not explore or develop those areas granted either by itself or through other companies[17] since there were no relinquishment provisions. The companies could therefore decide to 'sit on' the concession areas and do nothing for long periods of time depending on market conditions.

Royalties were the only source of revenue to HCs. Moreover, these were not based on the value of the oil produced, but upon the volume of production thus representing only a minor share of the proceeds of petroleum production. The 1949 agreement between Saudi Arabia and Getty Oil offers one such example.

---

[15] Supra n.7, Vol.1 at p. E-27. Emphasis added. We shall discuss this type of "frozen" contractual clause in Chap.5. A caution to HCs is that, they must guard against the insertion of this type of provision in a contractual arrangement and to ensure that contracts allow for flexibility and revision of terms in the event of changed circumstances.

[16] Smith D., & Wells L., supra n.2, at p.37.

[17] Hossain K., Law and Policy in Petroleum Development (1979) at p.110.

2.2. The Modern Concession:

The gradual evolution of the early concessions gave way to the modern[18] version of the concession. As noted in chapter one, HCs resorted to changing the early concession system through extra legal means. These took the form of a wave of nationalizations and renegotiations of these contracts through pressures brought to bear on the IOCs by HCs. As a combined result of these tactics, the terms and conditions of the modern concession have been markedly different from the earlier ones.[19] Basically, they are arrangements under which an oil company obtains a lease or licence from a government to explore for petroleum within a defined territory. The IOC provides all the capital for exploration, and if a discovery is made, the company is free to develop and market the oil produced.[20] In exchange, the company pays royalty and income tax. Bonuses and other taxes may be levied as well.[21] These contracts give the oil company more limited property rights, strictly define the timetable of operation, and the obligations of the company.[22]

---

[18] The term 'modern' refers to the extent to which the concession incorporates new trends which seek a rational development of the Country's resources and does not refer to an era in which a particular contract was concluded. See, Adede A.O.,"A Profile of trends in the State Contracts for Natural Resources between African Countries and Foreign Companies" (1980) 12 New York University Journal of International Law and Politics 423 at p.496.

[19] Supra n.3, at p.61.

[20] Barrows G.H., Worldwide Concession Contracts and Petroleum Legislation (1983) at p.4.

[21] Ibid.

[22] Broadman H.G., "Incentives and Constraints on Exploratory Drilling for Petroleum in Developing Countries" (1985) 10 Annual Review of Energy 217 at p.228.

The concession has three distinct stages. These are: 1.reconnaissance stage; 2.exploratory stage; 3. exploitation or production stage. In some contracts, the reconnaissance and exploratory stages are fused into one. The first stage is marked by the grant of a non-exclusive permit for a short duration to undertake surface work relating to geological or geophysical surveys, and normally does not include the drilling of exploratory wells. The second stage is characterised by the grant of an exclusive licence to explore for petroleum. This includes drilling, and its duration varies from country to country, with provisions for relinquishment of a proportion of the areas held. The last stage provides for the exploitation or production of petroleum and normally extends over a period between 20 to 30 years.

We shall now examine the terms and conditions of the modern concession, with the aid of some concrete examples from contracts concluded between HCs and oil companies.

The starting point for the grant of a concession is normally marked by the demarcation of the national territory including the off-shore area into blocks, and the grant of exploratory rights over a limited number of blocks. Terms are also included for the progressive relinquishment of most of the original area. An example of this can be found under the concession agreement of 1984 between the government of Somalia and Elf Somalie. Article 111 of the agreement headed 'Oil Exploration Permit and Oil Mining Leases' states:

> "3.1 Contractor is granted contemporaneously herewith an Oil Exploration Permit for the Contract area,........to conduct Exploration Operations during an initial exploration period of three (3) contract years. Three..successive extensions to the Oil Exploration Permit of one year each shall be granted to Contractor........, subject to contractor having fulfilled its obligations hereunder for the then current

> period,including the relinquishment provisions of Article IV...and having submitted....a Work Program and Work Program Budget which satisfies the minimum work and expenditure commitments."[23]

Article IV of the agreement which contains the relinquishment provisions is to the following effect:

> "4.1 If the Oil Exploration Permit has been extended for the first one (1) year period, on or before the third Contract Year Contractor shall relinquish....(25%) of the original Contract Area, excluding any portion of such Contract Area then converted into a field.[24]

This article goes on to provide for additional relinquishment of 40% of the contract area during the further extension of the exploration permit, for a third one year period in case there is no commercial discovery.[25]

The duration of the concession is limited. It can be renewed as long as the work requirements are met. Some contracts, however, as in the Somalia example, provide for a relinquishment of portions of the original contract area with each successive renewal of the initial licence granted. If a commercial discovery is made, the oil company will normally be required to apply for a production licence. In some cases, the transition from the exploration phase to exploitation of the reserves is automatic once substantial reserves are found. The Somali agreement for example, stipulates in Article 111:

> "3.5 Following a Commercial Discovery............... [C]ontractor shall apply to the Government for an Oil Mining lease covering the area so determined, and the Government shall grant such Oil Mining Lease

---

[23] Basic Oil Laws and Concession Contracts - South and Central Africa (Original Texts) (1987) Supplement No.XCI (91) at pp.13-14.

[24] Id., at pp.16-17.

[25] Ibid.

> covering such area, which shall thereupon be converted automatically into a Field.... The term of the Oil Mining Lease shall extend for twenty-five Contract years..."[26]

The concession grants to both oil company and the government certain rights and duties. The rights of the HC include ownership of the oil. As a general rule in most developing countries, ownership of the oil in situ is vested in the state. This is clearly stated either in legislation or in the contract. This is compatible with the concept of permanent sovereignty over natural resources as we noted in the last chapter. The HC also grants exclusive or non-exclusive rights to the IOC to explore, search and drill for, produce, sell and export petroleum. It also reserves the right to search and obtain substances other than those exclusively granted by the concession.

The most important aspect of the HC's rights relate to the financial benefits accruing to it from the concession. Royalties under the old-style concessions used to be the main form of revenue due to the government.

Under the modern contracts however, the HC reserves the right to levy a royalty in addition to other forms of return, such as taxes, on the income of the venture, bonus payments, surface rentals and other duties. An important consideration which must be noted in setting royalties is that the price to be agreed for crude oil cannot be determined until it is drilled and sold because of uncertainties about its characteristics and the price of the final product. On that account if a royalty rate is fixed, difficulties can arise when the returns on the project turn out to be far different than expected.[27] If the HC feels that the returns to the company are far higher than expected, pressures for re-negotiation of the rate will be brought and vice versa. This situation can sometimes sour the relationship between the parties and can even lead to complete breakdown of the relationship. Contracts must be structured to address this problem. The HC's aim must be to maximize the benefit accruing to it, while leaving sufficient benefits to the company to support its decision to invest.[28]

---

[26] Id., at pp.15-16.

Royalties may either be fixed or variable and payable in cash or in kind at the HC's option, depending on the terms of a particular contract. An example of the fixed royalty can be found in the Somali agreement. Article VIII of the agreement provides as follows:

> "8.1 Contractor shall pay to the Government a Royalty equal to fifteen percent (15%) of the annual gross production of Crude Oil....."
> 8.2 The Royalty on Crude Oil shall be payable in cash or in kind at the option of the Government......"

This type of royalty is independent of profitability. It has the advantage from the HC's perspective of assuring steady revenue from the moment production starts, and continues till the end of the life of the project.[29] Additionally, the computation of the value of revenues from royalties is much easier than that from other fiscal devices.[30] One must point out, however, that the price to be agreed for crude oil cannot be determined until it is drilled. This seems to be the problem with the Somali agreement. Sometimes the uncertainties about the characteristics of crude oil and the price of the final product will mean that setting a maximum royalty rate may not give the HC what it considers an adequate share of returns from a project for a particular period. Obviously, a satisfactory solution cannot lie in fixing a very high maximum royalty rate, because very high royalties are unattractive and risky.[31] These may adversely affect the operational decisions of the project. It may also encourage the selective drilling of rich fields and thus shorten their lives. There is the possibility that a high royalty will make a field, which was viable on a pretax basis, uneconomic after the royalty has been levied.[32] Provision must be made to resolve this special situation. A very good reference point for resolving this, it is submitted, can be found in the province of Alberta fiscal regime governing Crown leases for petroleum. Under this regime, oil and gas royalties are established in Crown leases which are, in turn tied to regulations which can be (and they have been) amended from time to time.[33] The Alberta government therefore employs a legal mechanism for changing royalties that is not bound forever to the contractual terms of the original lease.[34] In other developing countries, royalty rates have been set in relation to the nature of a field. Nigeria for example, has set royalty rates at 20% for onshore production, 18.5% for offshore production in water up to 100 meters, and 16.2% for offshore production in water depths exceeding 100 meters.[35] The problem may also be addressed by the introduction of a resource rent tax. This tax becomes applicable after an oil project has attained a rate of return to be specified on the basis of normal rates of return applicable in the petroleum industry taking into account inflation. In other words, the tax is applied only when the project has actually achieved a predetermined rate of profitability.[36]

---

[27] See, for example on the issue of royalties, Walde T., "The Role of Government in Mineral Development: Mining Legislation and Mineral Development Agreements" (1984) International Energy Law 1161 at pp.1389-1391.

[28] Faber M., "Some Old and New Devices in Mineral Royalties and Taxation" in Legal and Institutional Arrangements in Minerals Development (1982) 104 at p.105.

[29] U.N.C.T.C., Financial and Fiscal Aspects of Petroleum Exploitation (1987) at p.9.

[30] Ibid.

---

[31] Ibid.

[32] Ibid.

[33] See Canadian Institute of Resources Law, Alternative Management Regimes for Oil and Gas Activities Onshore in the Yukon and in the Beaufort Sea (1989)[unpublished] at p.49.

[34] Ibid. The disadvantage of this scheme to an IOC arises from uncertainty as to the royalty rates it will be called upon to pay throughout the duration of the agreement. Also this system may place a heavy burden on the IOC since a high level of production will not mean a high level of profits. Since royalties are calculated on production and not on profits, a high cost field may pay the same royalties as low cost fields of a similar size. This may have a deterrent effect on their development. See for example, supra n.3, at p.228.

The other type of fiscal device used in order to avoid the distorting effects of a high level of fixed royalties under the concession, is the progressive - or sliding scale - royalty which is related positively to production. The royalty rate under this scheme increases with production, and decreases when production goes down. The Oil Concession agreement between the Government of Ajman and Northland Minerals Limited of 1981 illustrates this approach:

---

[35] Supra n.3, at p.230. For an indepth analysis of examples of different methods used in the calculation of royalties in some countries, see for example, supra n.29,at pp.10-13; Smith D.,& Wells L., supra n.2, at pp.61-65; supra n.3, at pp.227-231.

[36] In general, there may be some difficulties with certain points of detail in any formula used to express the concept of resource rent tax, such as the specified rate of return after which the tax becomes applicable and the rate of the tax. However, there is wide agreement about its stabilising effect on mineral agreements, because it eliminates the main cause for re-negotiations of the fiscal terms. For a detailed discussion of the resource rent tax see, Garnet R.G.,& Clunies Ross A.I., "Uncertainty, Risk Aversion and the Taxing of Natural Resource Projects" (1975) 85 Economic Journal at pp.272-287. See also, Conrad R.F.,& Hool Bryce R., Taxation of Mineral Resources (1980); Kemp A., Petroleum Rent Collection around the World (1987) at pp.101-103, Chap.7; Gillis M.,"Evolution of Natural Resources Taxation in Developing Countries" (1982) 22 Natural Resources Journal at pp.620-648; Carden L.J., "Taxation - Resources Taxes, Royalties and other Taxes peculiar to the Mining Industry" (1977-78) 1 Australian Mining and Petroleum Law Journal at pp.491-499; Dowell R., ibid., at pp.500-503; Garnet R., ibid., at pp.620-648; Emerson C., "Taxing Natural Resource Projects" (1980) Natural Resources Forum at pp.124-145; Date-Bah S.K.,"The Contract as a Mechanism for Taxation" (1988) 6 Journal of Energy and Natural Resources Law 41 at p.44.

> "The Company shall pay the Government a fully expensed royalty equal to fourteen percent (14%) of the Posted Price of Crude Oil produced and saved in the Concession Area each year, excluding Crude Oil used by the Company in its operation hereunder, as gauged at the point after deducting the basis sediments and water. If the production of Crude Oil during a calendar year shall reach an average rate of fifty thousand (50,000) barrels per day the Company shall pay a full expenses royalty [expensing of royalties is a system whereby royalties are treated as an expense in the computation of income tax instead of crediting it against income tax] of fifteen percent (15%) of the Posted Price. If the production of Crude Oil during a calendar year shall reach an average rate of one hundred thousand (100,000) barrels per day the Company shall pay a fully expensed royalty of sixteen percent (16%) of the Posted Price. If the production of Crude Oil shall reach an average rate of one hundred and fifty thousand (150,000) barrels per day, the Company shall pay a fully expensed royalty of eighteen percent (18%) of the posted price.....".[37]

The rationale behind the progressive royalty is based on the fact that as output increases, the HC can capture a greater proportion of the total economic rent due to it. The danger here is that the oil company may consider its post-royalty revenue, and decide to cut-back on production where a comparatively small increase will increase the total royalty burden.[38] To put it more tersely, studies have suggested that:

> "....in terms of efficiency of development, the sliding scale royalty or a similar type of payments gets a very low mark....It creates contra-incentives to production, premature abandonment, retardation of intensive development investment, and loss of economic rent. Even in the case of tracts that are generally regarded to be highly productive and low risk, it would be necessary to implement a sliding-royalty scale on each lease as it declined in productivity in order to insure that ultimate recovery would not be reduced. Otherwise the contra-incentive to intensive development investment would remain".[39]

---

[37] Basic Oil Laws and Concession Contracts (Middle East Original Texts) Supplement LXXXI (81) at p.12.

[38] Supra n.29, at p.10.

[39] Jones R.O., Mead W.J., & Sorensen P.E, "Economic Issues in Oil Shale Leasing Policy" in Gary J.H., ed., Eleventh Oil Shale Symposium Proceedings (Golden, Col., Colorado School of Mines) (1978) at p.205. Quoted in Mikesell R.F., Petroleum Company Operations and Agreements (1984) at p.44.

Mikesell, for example, on this score suggests that "sliding-scale royalty or a similar arrangement based on a proportion of gross revenue may not be a desirable method of maximizing rents for the host government".[40]

In sum, it would appear that a combination of fixed and variable components of a royalty regime capable of responding to variable factors may be desirable. In this regard, it has been suggested that:

> "Royalties can be adjusted according to the development of world market prices of minerals....They can be graduated so as to encourage productivity and can be made to reflect the overall or average profitability of mining operations. Some contracts contain a fixed component of royalty (to provide a steady revenue) and a variable component so as to allow the host country to share in the economic risk and benefit of world market price development."[41]

This kind of royalty regime, for example, is in use in Jamaica.

Apart from royalties, the HC's other means of collecting economic rent takes the form of taxation. The oil company pays tax levied either through general corporate tax laws, special petroleum tax legislation or as provided for under the contract. Companies are however, exempted from payment of taxes other than those specified in the petroleum legislation or in the agreement. Taxes are generally levied on the net income of the company.[42] In Abu Dhabi, for example, the rate of income tax negotiated varies from one concession to another depending upon the size of the oilfield and its profitability. That country has adopted an income tax rate increasing progressively from 55% to 85% as the volume of production rises.[43] In Liberia, the taxable income derived by the IOC from its petroleum operations is subject to income tax at the rate of 50%.[44] Income taxes, in contradistinction to royalties, are tied to a measure of profitability . This has the advantage of securing for the HC a greater part of the profits generated by the undertaking. At the same time, it prevents to a lesser extent discrimination against less profitable oilfields.[45] However, HCs must be cautious about levying income taxes at a higher rate in respect of oil production. This may create a problem since they tend to make the IOCs less concerned about minimizing the costs of their operations.[46] Another important factor in the determination of the kind of tax regime to be adopted by HCs is the fact that income taxes accruing to it may be eligible for tax credit in the home countries of the IOCs. The effect of this is that an IOC will be able to obtain a credit in its home country for income taxes paid abroad.[47] The interests of the parties may therefore coincide in devising tax legislation and contracts in a way to allow the company to obtain the maximum tax credit in its home country.[48] The feasibility of this device will make the company accept a higher tax credit in the host country.[49]

---

[40] Mikesell R.F., ibid.

[41] Walde T., "Revision of Transnational Investment Agreements: Contractual Flexibility in Natural Resources Development", (1978) 10 Lawyer of the Americas, 265 at p.286.

[42] Income tax rates vary from country to country.In some cases they may be a special tax rate as in the case of OPEC countries which have a uniform tax rate of 85%. However, majority of HCs apply a tax rate of approximately 50%. See, Barrows Company Inc., World Petroleum Arrangements (1982) at p.31.

---

[43] Suleiman A., "The Oil Experience of the United Arab Emirates and its Legal Framework" (1988) 6 Journal of Energy and Natural Resources Law 1 at p.8.

[44] See, Section XVIII of the Amoco Liberia Company Exploration Agreement of 1983, in Basic Oil Laws and Concession Contracts (South and Central Africa Original Text, Supplement LXXVI(76) (1984) at p.47.

[45] Supra n.3, at p.232.

[46] To cite an example, if an oil company is taxed at the rate of 75% on the basis of income from existing production the HC is in effect paying three-fourths of all operating costs. This may lead to overspending on exploration or production which may not be in the HC's interest. See id., at p. 232-3.

[47] Ibid.

[48] Id., at pp.233-236. See also, United States National Petroleum Council, Third World Petroleum Development: A Statement of Principles (1982) at Chap.4.

Another source of HC revenue under the concession is bonuses. These take the form of: 1. a signature bonus[50] - which is payable upon the signing of the contract; 2.discovery bonus: -payable when a commercial discovery is made; and, 3. Production bonus: - payable as a stipulated amount upon the attainment of a stated level(s) of production. The Ajman agreement in Article 9 for example, provides that:

> "The Company agrees to pay to the Government the following amounts at the time and in the manner stated;
> (a) U.S.$400,000 (four hundred thousand) within thirty (30) days after the Effective Date.
> (b) U.S.$1,000,000.00 (one million) within (30) days after the discovery of Crude Oil in Commercial Quantities.
> (c)U.S. $1,500,000.00 (one million and a half) after regular exports of Crude Oil have reached and maintain an average rate of 50,000 to 100,000 barrels per day for thirty (30) consecutive days.
> (d) U.S. $2,000,000.00 (two million) after regular exports of Crude Oil have reached and maintained an average of 150,000 barrels per day for thirty consecutive days."[51]

Signature bonuses, it would appear, have a negative effect on production. They bring much needed foreign exchange to the HC, but are treated by the IOCs as part of their exploration budget.[52] They would therefore tend to spend less monies during the exploration stage.[53] The significance of the discovery and production bonuses lies in the fact that the HC could share in the immediate rewards of a bonanza strike, or of a production well.[54] These however, have very little influence upon the total revenue going to government and are not a particularly important fiscal device.[55]

---

[49] Ibid.

[50] For example, under the Somali agreement, the contractor is to pay the sum of $100,000 as a signature bonus upon the signing of the agreement. See Article XIII, supra n.23, at p.65.

[51] Basic Oil Laws and Concession Contracts -Middle East (Original Texts),Supplement LXXXI(81) at p.9.

[52] Supra n.3, at p.236.

[53] Ibid.

Before closing the matter on issues relating to the fiscal regime under the concession, one might add that the payment of area or surface rentals are provided for in most of the agreements. Again the Ajman agreement states in Article 10:

> "The Company agrees to pay to the Government as annual rentals a sum amounting to 250,000 (two hundred fifty thousand) U.S. dollars with an annual increase of ten percent (10%). Upon the discovery of Crude Oil in commercial Quantities no further increase would be applicable. The annual rent would remain at the same amount as that before discovery of Crude Oil in Commercial Quantities. Annual rentals are to be paid in advance for each year."[56]

Under this agreement sliding-scale surface rental fees are provided for. The fees are a means of discouraging retention of areas where no exploration is being done. Financial pressure may thus be exerted on the IOC to relinquish such areas, which might be given to other companies interested in carrying out exploratory activities in the relinquished areas.

The HC's obligations under the concession regime relate broadly to assisting the oil company in the execution of work programs. The government normally supplies or makes available to the company all the necessary geological, geographical, drilling, well location maps and other information relating to the contract area in its possession. It also undertakes to provide right of access to and from the contract area, and to grant an import licence to the oil company to bring in all materials and equipment which are necessary for the carrying on of its operations.

---

[54] Khan K.I.F., "Petroleum Taxation and Contracts in the Third World - A Law and Policy Perspective" (1988) 22 Journal of World Trade 67 at p.71.

[55] Supra n.43, at p.35.

[56] Supra n.37, at pp.9-10.

The oil company normally has exclusive rights to explore for, drill, produce, store, transport, sell, and export petroleum in accordance with the terms of the contract. It conducts all petroleum operations at its sole risk, cost and expense in accordance with the terms of the agreement. Also, whereas the IOC will normally be subject to the domestic exchange control regulations applicable in the HC, it is entitled to retain outside and freely transfer foreign currency received by it. This includes proceeds from the sales of petroleum.

The IOC's obligations under the contract are onerous. Once a contract is signed, the HC wants the exploration program to be executed as quickly as possible. To this end, the IOC has to fulfil certain work obligations and to spend a minimum amount of money at each distinct phase of operations. At the exploration stage for example, some contracts specify in detail the minimum amount of work that has to be done. It has been suggested that work obligations defined in terms of specific activities tend to discourage exploration.[57] This is so because the inflexible nature of obligations tend to compel the IOC to use limited resources to meet the requirements instead of exploring areas more promising. To reduce this disincentive, the 1986 Chinese agreements allow the IOC to exercise the choice of transferring work commitments on areas less promising to areas more promising.[58] This arrangement still gives the HC the benefit of a specified amount of guaranteed exploration.[59] Apart from specifications as to work obligations, most of the contracts provide for minimum expenditures, as already indicated. The Ajman contract on work obligations illustrates this. It provides in Article 5 as follows:

---

[57] Hoyt M.P, "Overview:Increasing Exploration Incentives in International Petroleum Agreements" in Proceedings of the International Bar Association, Energy Law '88 747 at pp.750-751.

[58] Ibid.

> "(C) The Company shall undertake to spend on prospecting, exploration, drilling or development operations, even though Petroleum may have been discovered in Commercial Quantities the following minimum amounts:-
> (1) The first year, U.S. $5,000,000.00 (five million)
> (2) The second year, U.S.$5,000,000.00
> (3) The third year, U.S. $1,400,000.00
> (4) The fourth year, U.S.$1,500,000.00
> The following years shall have minimum investment increase on the same proportion as in the third and fourth years.
> (D) If the expenditure in any year shall be less than the amounts specified above for such year, the company shall expend the deficiency during the next succeeding two years in addition to the amounts specified for those years. In the event that the expenditure in any year shall be greater than that required for such year, such excess shall be credited against expenditure obligations for any succeeding year or years."[60]

Apart from the financial obligations just illustrated, there have been interesting provisions relating to the duties of the IOC at the development and production phase. As we noted in chapter two, HC-IOC interests diverge when it comes to determining the rate of production and levels of output. The HC may press for expansion of output, while the company may program production within the context of their operations elsewhere. The Ajman contract is particularly interesting in its approach to this issue. Article 6 of the agreement states:

> "After discovery of Crude Oil in Commercial Quantities in the Concession Area, the Company shall proceed to develop in accordance

---

[59] Ibid.

[60] Supra n.37, at p.6.

> with good oilfield practice all productive structures, to install facilities which are necessary to production, storage and transport and to produce Crude Oil therefrom in reasonably substantial quantities having regard to the world demand for Crude Oil and the economic exploitation of the Petroleum of Concession Area."[61]

Thus, the criterion for determining the rate of production is clearly stated to depend on world demand for crude oil and the economic exploitation of the field.

Other duties of the oil company relate to the training of local personnel in various aspects of the petroleum industry and the transfer of technology. These provisions are included in most of the contracts. The crucial issue is whether they are rigidly enforced. This is an acute problem in HCs which must be addressed. To sum up the enormity of the problem, one writer had this to say about Nigeria which is a major oil producing country in Africa:

> "The country has not developed the capability to manage its petroleum resources by itself, all the crude oil is still produced by foreign operators. Even though some Nigerians who work in the industry occupy important management positions, the key management roles are performed largely by foreigners".[62]

In pursuance of HCs' indigenisation or localisation policy which would ensure a training program designed towards the eventual replacement of expatriate personnel by local personnel, an obligation must be imposed on IOCs to submit for approval detailed programs for recruitment and training of local personnel. It is suggested that such a training scheme should be geared towards employment in the technical and managerial positions in the oil industry. HCs should closely monitor the activities of the IOCs to ensure that all aspects of training relevant to the contemporary needs of the industry are being undertaken. It has long been recognized that inability to draw on domestic personnel for middle level and management positions has been a great obstacle in the drive to achieve more effective control, and even where domestic personnel are available to assume managerial positions, success in the form of a high degree of control is still far from being ensured. Local nationals appointed to top level positions frequently take the viewpoint of foreign headquarters.[63] If this state of affairs can be excused due to established corporate practice, then an acceptable mode of training can only be realised if this is directed to relate to each country's own peculiar circumstances and the demands of the industry at each given point in time. But of course, this training must also be such as to project and take into account the ever-changing and complex advancements to keep abreast with whatever innovations and strategies pertain in the developed countries. Contractual arrangements must stress the importance of training and employment coupled with constant monitoring and support measures designed towards the ultimate realization of these objectives.

---

[61] Id., at p.7.

[62] Olorunfemi M.S.,"Managing Nigeria's Petroleum Resources" (1986) OPEC Bulletin 24 at pp.25-26.

Another issue of concern that must be addressed under the concession agreement is the protection of the environment and the adoption of anti-pollution measures. It is important that contractual provisions include an obligation on the IOC,in the execution of its operations, to adopt measures which are appropriate and in harmony with the technology in use in the international petroleum industry. This will ensure that operations of the IOC does not cause damage to, or endanger the environment. The IOC must also be responsible for the control, and clean up of any pollution caused by its operations.

---

[63] Asante S., & Stockmayer A., "Evolution of Development Contracts, the issue of Effective Control" in supra n.28, 53 at pp.60-62.

Finally, provisions must be included for the supply of the domestic crude oil needs of the HC.

2.2.a. An Assessment:

The main advantage of the modern concession is that "it is a tried- and-true system that works".[64] It is a flexible system that can accommodate various approaches for its implementation. It can be enacted into legislation or negotiated by contract to achieve the same results.[65] It is straightforward, well defined system and can easily be adapted by any country.

It has eliminated the main drawbacks of the early concessions such as; the very large areas, long duration, modest financial benefits to the HC, the complete exclusion of the HC from any involvement in oil operations, and participation in the decision-making process.

The modern concession satisfies most of the major demands of the HC including their authority to exercise some review of, and control over decisions of the IOC. It requires for example, minimum exploration work programmes, approval of exploration costs, and of field development plans.

The concession system may meet the immediate needs of certain HCs with unproved petroleum potential, geographically isolated exploration areas and little local expertise and capital. In such areas, a concession-type agreement may be a useful device for attracting foreign oil companies to undertake exploration.

---

[64] Supra n.42, at p.42.

[65] Ibid.

The main weakness has been the less direct involvement of the HC in the management of petroleum operations. However, most of the recent contracts, as pointed out, now provide for HC participation through joint ventures and training programs.

3. Production-Sharing Agreements:

The production-sharing contract[66] originated in Indonesia in the 1960s. It was subsequently adopted by other countries in Asia, the Middle East, Latin America and Africa . Under the PSC, the HC, normally through its national oil company, grants the oil company (or contractor) a contractual right to explore and develop a given area. The contractor provides the capital and bears all the risk of exploration and development. In case of a commercial discovery, the oil company recovers its investment and operating costs by a share of the crude oil produced. This is normally called "cost oil". The balance of production which is called "profit oil",[67] is then divided between the HC and the company according to the terms of the contract. The scope of the PSC can be illustrated by the 1976 draft model PSC of the government of Indonesia[68] which states in section 1 that:

> "This Contract is a Production Sharing Contract in accordance with the provisions herein contained. PERTAMINA shall have and be responsible for the management of the operations contemplated

---

[66] Hereafter referred to simply as PSC.

[67] The HC's share is analogous to the royalty received under concession contracts after the project becomes profitable. See, supra n.23, at p.229.

[68] All subsequent references to the Indonesian Contract are to this agreement unless otherwise stated. For a detailed study of the oil industry in general as well as the evolution of PSCs in Indonesia, see Bartlett A.G.,Barton R.J., Bartlett J.C.,Fowler G.A., Hays C.L., Pertamina - Indonesian National Oil (1972); Rochmat R., Contractual Arrangements in Oil and Gas Mining Enterprises in Indonesia (1981);Fabrikant R., Legal Aspects of Production Sharing Contracts in the Indonesian Petroleum Industry (1973).

> hereunder. (CONTRACTOR) shall be responsible to Pertamina for the execution of such operations in accordance with the provisions of this Contract, and is hereby appointed and constituted the exclusive company to conduct Petroleum Operations. (CONTRACTOR) shall provide all financial and technical assistance required for such operations.
> (CONTRACTOR) shall carry the risk of Operating Cost required in carrying out operations and shall therefore have an economic interest in the development of the Petroleum deposits in the Contract Area. Such costs shall be included in Operating Costs recoverable as provided. .... During the term of this Contract the total production achieved in the conduct of such operations shall be divided between the Parties..."[69]

The status of PERTAMINA vis-a-vis that of the contractor is not very clear under the contract. The provision could be interpreted to give responsibility for the management of the "contemplated operations" to PERTAMINA. The IOC acting as contractor to PERTAMINA is responsible for the actual execution of the work program agreed to by PERTAMINA, which has management control over the manner in which the work is performed. It has been suggested that management control does not mean that PERTAMINA insists on making every decision. In the words of Sajidiman (former head of the Foreign Contractors Coordinating Division of PERTAMINA):

> "We do insist on being able to make any decision we find necessary. If we find the policies of any of our Contractor Companies contrary to the best interests of Indonesia, we can change them by making a management decision".[70]

Under the PSC, ownership of the petroleum remains vested in the state (or the national oil company), and the oil company only acquires title to its share of the crude oil at the point of export and not at the wellhead, as under the traditional concession.[71]

---

[69] Basic Oil Laws and Concession Contracts - Asia and Australasia (Original Texts) Supplement L11 (52) at pp.2-3.

[70] Sajidiman S., A Review on Production Sharing Activities: Expose to Foreign Bankers visiting Indonesia (March 1975) p.2 quoted in Carlson S., Indonesia's Oil (1977) at p.20.

The duration of the PSC is quite short, ranging between 15 to 30 years. The exploration period is much shorter, and normally does not exceed six years, so that in case there is no commercial discovery within that period the contract will automatically become null and void. Minimum exploration obligations and annual work programs, as well as relinquishment provisions are provided for. An important consideration of the HCs is the question of the definition of a "commercial discovery". Some of the more recent contractual provisions stipulate that what constitutes a commercial discovery must be mutually determined by both parties. For example, Article 15 of the 1988 Exploration and Production Sharing Contract between the Republic of Gabon, Tenneco Petroleum and Wintershall AG states:[72]

> "15.1. In the event that the Contractor discovers Hydrocarbons, it shall inform the Administration thereof in writing within ten... days of the completion of the tests which lead to the assumption of the existence of a Deposit.
> 15.2. The commercially exploitable nature as such of one or more discoveries shall be determined by agreement between the Parties who shall meet for that purpose, and shall set forth their agreement in a document jointly signed.
> 15.3. To that effect, the Contractor shall furnish all information enabling the Administration to examine in detail the facts relating to

---

[71] Supra n.3, at p.139. Asante, points out for example, that "it is true that the Indonesian model [i.e.PSC] clearly locates ownership of the production in the host state......[T]his distinction tends to be artificial in functional terms and is, at best, only a technical device for conforming to the external trappings of national sovereignty over natural resources". See Asante S.K.B., "Restructuring Transnational Mineral Agreements" (1979) 73 American Journal of International Law 335 at p.365. Fabrikant concludes that "perhaps the only legal significance of postponing the transfer of title is that it might inhibit legal actions brought by Contractors against purchasers of nationalized oil". See also, Fabrikant R., "Production Sharing Contracts in the Indonesian Petroleum Industry" (1975) 16 Harvard International Law Journal 303 at p.340 footnote.73.

[72] Basic Oil Laws and Concession Contracts-South and Central Africa (Original Texts)(1989) Supplement No. XCVIII (98) at p.26.

> the discovered Deposit and to express a fully informed opinion on the "bona fide" nature of the commercially exploitable discovery. Such information must be furnished as and when it comes to the knowledge of the Contractor".

The insertion of a provision of this nature is most desirable. It eliminates a potential source of friction since one party might consider a discovery to be commercially feasible whereas the other party might not. Under the Gabon agreement both parties must agree as to whether a discovery is commercial. If the parties disagree either party may develop the field alone under a sole risk provision. The other party may thus participate again after paying a penalty. Another suggestion that may be offered is that the contractor could declare a commercial discovery in the first instance and make this subject to challenge by the HC.[73]

The rights and obligations of the parties under the PSC are not fundamentally different from those already examined under the concession contract. As already noted, the IOC advances all the necessary funds for the petroleum operations including the foreign personnel required for the performance of the work program. The Indonesian model described above, however, leaves the latter issue open. The IOC is normally responsible for the preparation and execution of the work program. Under the PSC of 1989 between the NOC of the State of Aruba and Hamilton Oil Corporation, for example, the latter is required to:

> "5.2.4 Conduct all Petroleum Operations in a diligent, conscientious and workmanlike manner, in accordance with the applicable law and the Contract, and the highest contemporary standards of operating practice within the international Petroleum industry designed to achieve efficient and safe Exploration and production of Petroleum and to maximize the ultimate economic recovery of Petroleum from

---

[73] See for example, Section 35 of the Canada Petroleum Resources Act,1986.

the Contract area".[74]

Thus, very strict standards are set for the performance of the duties of the IOC as is the case in the international petroleum industry. In the undertaking of its operations, the IOC is also under a duty to take measures for conservation, safety of life, property, crops, fishing and navigation. It must also take measures to prevent damage to the environment and pollution. If, despite the taking of such precautions, any damage or pollution occurs, the IOC will normally be responsible for restoration and cleaning up the damage at its own cost.[75]

Furthermore, the IOC is under a duty to submit promptly to the HC or its NOC originals of all data relating to geological, geophysical, drilling, well, production and other reports collected during the term of the contract. The Indonesian contract states in Section V (1.2)(l) that "[c]ontractor shall submit to PERTAMINA copies of all such original geological, geophysical, drilling, well, production and other data and reports as it may compile during the term hereof;". It is interesting to point out that problems can arise in the construction of such provisions. It is not apparent on the face of such provisions whether the duty of the IOC is just to submit the "raw data" that it compiles, or whether this obligation extends to cover an evaluation of such reports. It is submitted that the requirement to submit reports and data should go on to include evaluations on such reports. This must be categorically spelt out in the contract. Most of the contractual provisions also prohibit the IOC from disclosing or otherwise selling the data to outside parties. In any case where a disclosure has to be made in the interest of carrying out petroleum operations, the prior approval of the HC must be sought.

---

[74] Basic Oil Laws and Concession Contracts - Central America and Caribbean (Original Texts), Supplement No.72 at pp.31-32.

[75] See for example, id., at p.32.

Also, the IOC is under a duty to employ as far as possible locally qualified personnel in its operations. Additionally, it must train local personnel in the administrative, technical and management levels of petroleum operations. The costs of such training are normally included in the operating costs of the IOC, or as agreed between the parties.[76] It has been suggested that the training of local personnel should be both theoretical and practical, covering all aspects of the petroleum industry. The IOCs must provide in-house seminars as well as on-the-job training.[77] The PSC of 1985 between the government of Guatemala and Amoco (Guatemala) Petroleum Corporation is interesting in this regard. It states that:

> "23.1 The parties may enter into agreements for studies and joint research with regard to the procedures and techniques that the Contractor employs in the development of the petroleum operations deriving from this contract. Said agreement may refer, without being limited thereto, to the following: frequent consultations, joint studies, discussions on technical problems, exchange of operating technology between the experts of the Ministry and the Contractor's personnel. Likewise, the experts of the Ministry may, with the Contractor's consent, take part in the scientific research and development of the operations conducted by the Contractor in Guatemala or abroad".[78]

The advantage of such programs would be to build up national competence as well as the necessary human resources.

The IOC must also meet the domestic crude oil requirements of the HC. It is paid a price for this which is more closely related to the actual cost of production than to the international market price.[79] It also has the right to freely dispose of, and export its share of crude oil and to retain abroad the proceeds from such sale.

---

[76] See, Section XII of the Indonesian agreement. Supra n.69, at p.35. The Indonesian contract provides for training costs to be included in the operating costs of the IOC.

[77] Supra n.6, at pp.36-37.

[78] Supra n.69, Supplement No.61, at p.31

Rights of the IOC under the PSC normally include the right to sell, assign, transfer or convey its interests under the contract to a third party. It can only do so with the prior written consent of the NOC.

The duties of the NOC of the HC relate basically to consulting with the IOC on a regular basis with a view to assisting it in the execution of the work program. The Indonesian contract entrusts to Pertamina (the NOC) management of petroleum operations. In addition, it assists and consults with the IOC "with a view to the fact that [the IOC] is responsible for the work program".[80] It is not very clear in trying to determine the respective roles of the IOC and the NOC under the Indonesian model. Suffice it to say here that from a practical point of view, it is difficult to separate overall management of operations from their day to day conduct in a situation where the IOC bears the financial risk. The joint control of operations seems to be the best option in this regard. Under some of the PSCs, for example, under the Aruba contract, a Joint Review Committee comprising representatives of the HC as well as the IOC is established. This committee has the mandate to review and make recommendations to both parties on matters such as:

---

[79] The determinants in setting prices to be paid for crude oil supply to the host country are too complex to be discussed here. See for example, Fabrikant R, "Production Sharing Contracts in the Indonesian Petroleum Industry" (1975) 16 Harvard International Law Journal at p.303. An important question that is sometimes raised in this regard is that; if title to the oil does not pass to the IOC till the point of export, how then could it be entitled to receive a price for the oil supplied by it to the domestic market? For a discussion of this issue see, id., at p.341.

[80] Supra n.68, at p.18. Asante for example, points out that notwithstanding the conferment of management responsibility on the NOC, the practical importance of the Indonesian provision is diminished by the fact that operational duties are entrusted to the IOC. See, Asante S.K.B., Supra n.71, at pp.364-365.

> "(i) All Work Programs, Budgets of Petroleum Costs and other reports and proposals required to be submitted to [the NOC];
> (ii) CONTRACTOR's reports.....and statements submitted in accordance with....Accounting Procedure;
> (iii) CONTRACTOR's proposed production plan;
> (iv) Terms of contracts with sub-contractors and performance of sub-contractors' work;
> (v) Any problems arising in Petroleum Operations; and
> (vi) Such additional subjects as may be requested by either Party".[81]

Some HCs also reserve under the PSC the right of participation in the event of a commercial discovery. Article 19 of the Gabon contract provides as follows:

> "19.1. When the exploitation of discovered deposit starts, the State automatically participates for a percentage equal to at least twenty-five percent (25%) in the Contractor's rights and obligations resulting from the Contract,........
>
> By reason of this participation, the State shall pay for up to twenty-five percent (25%) of the development and exploitation expenses, excluding exploitation costs. This participation of the State shall take effect as of the date of the starting of production.
>
> 19.2. If the State wishes to take a participation of more than twenty-five percent...it shall inform the contractor in writing,specifying the percentage of participation it wishes to take. The conditions of the acquisition of the said supplementary participation shall be determined by agreement of the parties..These conditions shall not affect the time within which the Contractor will recover the unrecovered Petroleum Expenses unless the parties agree to the contrary.".[82]

It seems that a provision of this nature does not differ from the usual PSC. This is so since all the advantages that the HC gains from participation can be achieved by including adequate provisions in the contract itself, to permit, for example, an increase in the HC's share of production.[83] The point being made here is to illustrate what seems to be a variation of the PSC. In practical terms however, a provision of this nature is unnecessary since the goals of the HC can be achieved through the normal PSC.

---

[81] Supra n.69, at pp.42-43. Action may be taken on such recommendations though they are purely of an advisory nature. See section 5.5.4., ibid.

[82] Supra n.72, at p.35. By Article 24 of the Agreement, the contractor has the right to receive not more than 50% of the net production of crude oil for cost recovery purposes in any given year. Article 25 provides that after deduction of the crude oil for cost recovery purposes, the quantity of oil remaining is to be shared in the following proportions: HC -65%, IOC-35% where production is less than 10,000 barrels; where production is equal to or less than 20,000 barrels per day HC -70%, IOC-30%; where production reaches 30,000 barrels per day HC-80%, IOC-20%;and finally, where production exceeds 30,000 barrels per day HC-85%, IOC-15%.

We shall now turn to an examination of the fiscal regime under the PSC. The fiscal mechanism is determined by the terms under which costs are recoverable and the sharing of the "profit oil" between the parties. This was the only fiscal provision under the original concept of the PSC.[84] In recent times, however, royalties and income tax have been included.

The starting point here is that a formula is provided which allows the IOC to recover its costs out of production. As already noted, this is called "cost oil". The cost recovery provisions of the Aruba contract, which is similar to the Indonesian model states in Section 6.2. thus:

> "Contractor will recover all Petroleum Costs out of the sales proceeds or other disposition of the required quantity of Crude Oil equal in value to such Petroleum Costs which is produced and saved hereunder and not used in Petroleum Operations PROVIDED THAT in respect of any Calendar Year the total amount of Crude Oil allocated ......shall not exceed fifty percent (50%) of the gross production for such Calendar Year, and to the extent that any amounts of unrecovered Petroleum Costs cannot be reimbursed from such fifty percent (50%) of gross production in any Calendar Year, such unrecovered amounts shall be carried forward for recovery in the next succeeding Calendar Year or Years until fully recovered. Contractor shall be entitled to take and receive and freely export such Crude Oil. For the purpose of determining the quantity of Crude Oil delivered to CONTRACTOR required to cover said Petroleum Costs, the Net Realized Price....of all

---

[83] Supra n.3, at p.79.

[84] Supra n.29, at p.20.

Crude Oil produced and sold from the Contract Area during the Calendar Year will be used".[85]

Provisions for cost recovery can have two elements. Firstly, they often specify the pace at which exploration and development costs are recoverable as shown in the Aruba contract.[86] Secondly, there may be a ceiling on the amount of oil production available for cost-recovery purposes.[87] The percentage of oil for cost recovery purposes varies from country to country. Generally, a percentage of between 30% and 50 % is made available on a yearly basis for cost recovery. In some of the PSCs however there is no ceiling to cost recovery and the whole production can be allocated to the IOC for such purpose in a given year.[88] It should be observed that the slower the pace at which costs can be recovered and the lower the proportion of oil available for cost recovery purposes, the greater will be the profit-oil share in the early years of production. This ensures that the NOC receives some profit oil early in the producing life of the field.[89] Conversely, a slower rate of recovery of costs has an adverse effect on the present value of the returns to the investor.[90]

After the deduction of "cost oil", the remaining portion of crude oil is divided between the HC and the IOC according to an agreed formula. This is known as

---

[85] Supra n.69, at pp.44-45.

[86] Supra n.29, at p.20.

[87] Ibid. For example, under the Aruba contract the IOC can only recover up to fifty percent of the gross production in any calender year. Any unrecovered costs are carried forward for recovery in the next succeeding year until full recovery of the amounts invested.

[88] Supra n.3, at p.75.

[89] Supra n.29, at p.20.

[90] Ibid.

"profit oil" or "production split". Such profit oil is shared between the HC and the IOC according to certain percentages negotiated and set out in the PSC. Normally, the HC may take its share of production in cash or in kind or partly in cash and partly in cash. An example of "profit oil" split under the Indonesian contract is as follows:

> "6.1.3 Of the Crude Oil remaining after deducting Operating Costs, PERTAMINA shall be entitled to take and receive sixty-five and ninety-one hundredths percent (65.91%) and CONTRACTOR shall be entitled to take and receive thirty-four and nine hundredths percent (34.09%)".[91]

This split is made on a pre-tax basis. The Republic of Gabon PSC offers an illustration of profit sharing based on daily production. It states in Article 25 that:

> "25.1 After deduction on the Net Production in connection with the recovery of Petroleum Costs....,the quantity of Hydrocarbons which remains shall be shared between the State and the Contractor, as follows:
>
> a) When the rate of Total Available Production.....is equal to or less than ten thousand barrels per day, the Remaining Production is divided between:
>
> - the State: Sixty-five percent;
> - the Contractor: Thirty-five percent.
>
> b) When the rate of Total Available Production in the Delimited Zone exceeds, during thirty consecutive days, ten thousand barrels per day, and equal to or less than twenty thousand barrels per day, the additional portion of the Remaining Production is divided between:
>
> - the State: Seventy percent;
> - the Contractor: Thirty percent.
>
> c) When the rate of the Total Available Production in the Delimited Zone exceeds, during thirty consecutive days, twenty thousand barrels per day, and is equal to or less than thirty thousand barrels per day, the additional portion of the remaining production is divided between:
>
> - the State: Eighty percent;
> - the Contractor: Twenty percent.

---

[91] Supra n.69, at pp.22-23. It has been suggested that a clause giving the IOC the right to control the disposition of at least part of the production is frequently critical to an IOC's decision to enter into a PSC. See, Smith E.N., & Dzienkowski J.S., "A Fifty-Year Perspective on World Petroleum Arrangements" (1989) 24 Texas International Law Journal 13 at p.38 footnote.179.

d) When the rate of the Total Available Production in the Delimited Zone exceeds, during thirty consecutive days,thirty thousand barrels per day,the additional portion of the Remaining Production is divided between: - the State: Eighty-five percent;
- the Contractor :Fifteen percent".[92]

Thus it can be seen that under this scheme of profit sharing, the allocation of profit oil changes as different production levels are reached.

3.1. An Assessment:

The principal advantage of the PSC from the perspective of the IOCs is that they can control their own share of the crude oil. Furthermore, they can control the destination of the NOC's share of crude oil if the NOC decides not to take its share in kind.[93]

The mechanism of the PSC allows HC participation in control of petroleum operations. This is done through an operating or management committee. However, this significant institutional arrangement for control can be practically undermined by lack of technological and management expertise.[94] The inclusion of strong provisions for accelerated training and transfer of technology especially in countries just embarking on oil development would, it is suggested, go a long way in making HC participation meaningful.

Another merit of the PSC arrangement is that the HC is given a stated minimum share of production which is independent of exploratory, development costs and the profitability of the IOC.[95] Furthermore, it guarantees the HC an earlier cash flow through its share of the "profit-oil" than other contractual mechanisms.[96]

---

[92] Supra n.72, at p.43. For case studies of the fiscal regimes of PSCs of other countries, see supra n.3, at pp.149-156; Mikesell R.F., supra n.39, at chaps.5-8.

[93] Dam K.W., Oil Resources - Who Gets What How ? (1976) at p.18.

[94] For a discussion of the practical effect of management rights of the HC under the Indonesian PSC for example, see, Fabrikant R., supra n.68, at pp.335-336.

As regards the fiscal regime under the PSC, the inclusion of a progressive profit-oil split ensures that the profit-oil going to the HC increases on a sliding scale related to the level of production. This is obviously a major improvement on the royalty structure of the old concessions.

The PSC, like the other contractual arrangements also has weaknesses, which will now be briefly outlined. Firstly,it is not flexible in so far as market changes such as price increases are concerned. If the price of oil increases substantially, the profitability of the IOC on a given share of oil increases considerably giving it a greater share of the revenue than would ordinarily have been conceded under the contract.[97] The PSC does not contain provisions to capture for the HC the "windfall profits" accruing to the IOC on the sale of their "profit-oil".[98] The weakness arises because the "profit oil" split remains static and does not automatically adjust for the HC to capture an increasing share of such oil in the event of price increases. Thus,

> "[i]f a field were still at a fairly early state of exploitation and development costs had not yet been recovered, the result would be that less oil would be required for cost-recovery purposes and more would be available for profit-oil sharing....[T]he Government would share in the gains from the price rise. If the main field development costs had already been recovered, the value of the Government's own share of profit oil would be increased from a price rise, but it would not

---

[95] Supra n.6, at p.53.

[96] Id., at p.54. The PSC has an advantage over the participation and concession agreements in this regard. It guarantees to the HC a stated minimum share of profits as soon as production starts.

[97] Supra n.29, at p.22.

[98] Ibid.

actually receive an increased share of the oil".[99]

To get round the problem of capturing for the HC a share of the profits where the price of oil increases, it has been suggested that it is feasible to provide for an adjustment of the "profit oil" split in which the HC's share increases as oil prices increase.[100] Other solutions have involved the introduction of special profit taxes as in the case of Malaysia. In that country the IOC is required to pay an "excess profits" tax which is computed on the basis of 70 percent of the difference between market price at any time and an agreed base price on its share of the "profit oil".[101] Angola has used a price cap mechanism[102] to capture for the state excess profits in the event of an increase in crude oil prices.[103] The practical implementation of these devices, however are not without their attendant problems. Also, some HCs may resort to changing their tax laws to deal with this situation but this may create disincentive effects and discourage potential investors.

Secondly, the PSC cannot be used as a standard form of agreement in the development of the oil resources of the HC. The potential reserves within a country may differ. Some areas may have proven reserves, others marginal or little. The application of a standard PSC to the various areas may prove to be inadequate.[104]

---

[99] Ibid.

[100] Supra n.6, at p.53.

[101] Id., at p.54.

[102] For an illustration of how the price cap is calculated, see Article 21 of the Model Production Sharing Agreement of Angola dated May 1989, supra n.23,(1989) Supplement No. XCIX (99) at p.121.

[103] Supra n.3, at p.247.

[104] Supra n.29, at p.22.

For example, whereas the contract may be adequate to deal with the supervisory and management aspects, there would have to be important adjustments to deal with the fiscal package.[105] ~~It~~ is prudent in such situations to deal with the various areas on the basis of individually negotiated contracts if the HC is to receive maximum benefits from the development of the areas within its jurisdiction.

It would appear that the PSC is based on equitable sharing, so that it should be possible to include additional terms to deal with particular problems where the standard contract fails to adequately accommodate the interests of both parties.

4. Risk-Service Contracts:

The Risk-Service Contract[106] is most frequently used in South America, some Middle Eastern and African countries. It is important to note that the RSC is distinguishable from the "Pure Service Contract or Non-Risk Service Contract". The Pure Service contract is a contract for technical, financial and commercial services rendered to the HC or its NOC by an IOC. For the services rendered, it is remunerated by the HC through the payment of a flat fee, normally related to production plus a 'reasonable' profit regardless of the outcome of the project.[107] The HC supplies the necessary capital (either using its own funds or through grants or loans). It therefore assumes all the risks inherent in the project.[108] This arrangement is not widely used and is limited to HCs which are already producing countries,[109] such as Abu Dhabi, Saudi Arabia, Kuwait and Venezuela.[110]

---

[105] See, ibid.

[106] Hereafter referred to as RSC. It has been suggested that, to label an agreement in which the IOC puts up all the capital at risk and is rewarded solely on the basis of the outcome of a risky investment a service contract is a clear misuse of the term. This usage has however, evolved in large part because HCs have for reasons of public policy wanted to avoid any association with the traditional concession agreement in dealings with IOCs. See, Mikesell R.F., supra n.39, at p.92.

[107] Supra n.1, at p.300.

[108] Ibid.

The RSC is similar to the PSC, and shares with it the basic features as to duration, work obligations etc. The main difference between them lies in the mode for recovery of costs and the remuneration of the IOC. The distinctive feature of the RSC is that the oil company is remunerated in cash and not in crude oil (though there may be clauses which permit the IOC to buy back a certain quantity of crude oil at international prices from established production). In the PSC, the IOC is basically remunerated through a share of the quantity of crude oil produced. Thus, whereas the PSC refers essentially to arrangements where the IOC and the HC share the output of operations in predetermined proportions, the RSC involves the performance of services for a stated fee. The Pure Service Contract is different from the Risk Service Contract in the sense that with the former the IOC is paid for its services regardless of the outcome of the venture.

The following discussion will highlight the distinctive features of the RSC and to assess its suitability as a contractual device for the HC.

Basically the RSC involves the hiring of the services of the IOC by the HC. The IOC advances all the necessary risk capital for exploration and development operations as well as any other obligations assumed under the contract. In the event that there is no commercial discovery the contract comes to an end, and the funds advanced are not refundable. In case of commercial production, the IOC is reimbursed for its costs and investments with or without interest and paid for its services according to the terms of the contract. Payments to the IOC take the form of cash payment (or a portion of the oil which it is entitled to purchase at a discount to world market prices).[111]

---

[109] Supra n.3, at p.97.

[110] Ibid.

The scope and object of the RSC can be vividly illustrated by the Service Contract of Ecuador between Esso/Hispanoil and Corporacion Ecuatoriana del Petroleo (CEPE which is the Ecuadorian NOC) of March 1985. The contract states:

> "5.1. The object of this Contract are the services to be rendered by Contractor to CEPE for exploration and exploitation of hydrocarbons in the Contract Area. Contractor shall have the exclusive right to undertake exploration and exploitation activities in the Contract Area as well as to carry out the services described hereunder, except if otherwise specified in this Contract. Exploration and exploitation of hydrocarbons shall be carried out in accordance with plans and programs agreed by CEPE and Contractor......and to this end Contractor agrees to render the following services:
>
> 5.1.1. TECHNICAL: These are the necessary operations to explore the Contract Area, to evaluate any reservoirs discovered therein, and to develop and produce Commercial hydrocarbon fields in Areas Reserved for Exploitation
>
> 5.1.2. FINANCIAL: This is the supplying of its own economic resources, irrespective of the source thereof,that have been registered at the Central Bank of Ecuador as investments......in order to carry out exploration and evaluation operations and, in the event of a discovery of Commercial fields, all the funds necessary to finance Development and Production Investments, as well as any other resources required for performing the obligations acquired by Contractor by virtue of this Contract.
>
> 5.1.3. ADMINISTRATIVE: These consist in the application of efficient and appropriate techniques on: organization, administrative services, and any other activities that may enable Contractor to perform its

---

[111] Supra n.6, at p.55.

obligations under the Contract......"[112]

Under the RSC, ownership of the oil in situ or at the well-head is vested in the HC or its NOC. The IOC is considered as, or assumes the legal status of, a "contractor" working for the HC and has no title to crude oil produced.[113] In this regard for example, Article 20 of the Ecuadorian contract entitled "Real Rights", perhaps to emphasise the ownership rights of the HC provides that:

> "The Ecuadorian State, through CEPE, is the sole and unconditional owner of all hydrocarbons and accompanying substances in any physical state related thereto, and it therefore is also the owner of any hydrocarbons recovered as a result of the services rendered by Contractor hereunder as well as of any areas expropriated or awarded to CEPE that are part of the Contract Area as well as of their respective rights of way".[114]

Also, the RSC normally provides for the transfer of all immovable property used in the operations to the HC or its NOC upon the termination of the contract. A 1979 Model Brazilian RSC between Petroleos Brasileiros S.A. (Petrobras) and Private Contractors stipulates in Article 18 that:

> "The Fixed Assets related to the Operations contemplated in this Contract shall be transferred to PETROBRAS at the end of the Exploration period or of its additional periods in the event a Commercial Field is not discovered or at any time, upon the early termination of this Contract. If any Commercial Field is discovered and developed by CONTRACTOR, the Fixed Assets shall be transferred to PETROBRAS as from the Date of Commencement of Commercial Production of each field in whole or in part,...."[115]

---

[112] Basic Oil Laws and Concession Contracts - South America (Original Texts) (1985) Supplement LXXX (80) at pp.16-17.

[113] Supra n.1, at p.300.

[114] Supra n.3, at p.52.

[115] Basic Oil Laws and Concession Contracts (Central and South America) supplement No.LIX (59) at pp.28-29.

The rights and duties of the parties under the contract, for example, those relating to requirements for work programs, periodic relinquishment,submission and approval of annual budgets, employment of local personnel and determination of the agreement if petroleum is not discovered, are similar to the contract forms we have considered.

As regards control of operations, a management committee is usually formed which oversees and ensures that operations are carried out according to the terms of the contract. The Ecuadorian RSC again offers an interesting illustration of the structure and functions of such a committee, which is described thus in Article 4.22:

> "ADMINISTRATIVE COMMITTEE: This is the body that shall manage this Contract and shall be composed of two representatives from CEPE and two representatives from Contractor to perform the functions determined hereunder pursuant to the powers determined by CEPE's Board of Directors and Contractor, as the case may be.
>
> The Contract's Administrative Committee has the purpose of coordinating and controlling the relations between CEPE and Contractor originating from Contract performance so as to attain efficiency and speed in administrative actions and to assess the fulfilment of annual operating programs. Contractor shall be responsible for technical operations.
>
> The resolutions of the Administrative Committee, adopted within the scope of its powers, represent CEPE's agreement with Contractor except in such cases when according to the Law, CEPE's Board of Directors should undertake such resolutions".[116]

It is suggested that the incorporation of a structure of this kind in RSCs is highly commendable since it ensures that the activities of the IOC are closely monitored. As a result, it will surely try to live up to expectations and to fulfil its obligations in a diligent and efficient manner.

---

[116] Id., at p.13.

The services to be performed by the IOC under the RSC relate mainly to the exploration and development phase upon determination of commercial discovery. In other cases, this may extend to production and marketing of crude oil as well. In Nigeria for instance, once commercial production has commenced, the NOC takes over operations within a specific period. It may also exercise the option to retain the IOC to continue operations on its behalf, or carry out production operations jointly. Thus Article 9 of a RSC of 1979 between a Private Company and the Nigerian National Petroleum Corporation (NNPC) provides:

> "9.1 NNPC shall fully take over and conduct all Production Operations for the first Production Unit of a Commercial Field within (3) three years of the Date of Commencement of Commercial Production from the relevant field, provided however, that NNPC shall give CONTRACTOR six (6) months notice to that effect. Should NNPC take over the operation of a Production Unit or field then it shall also at CONTRACTOR's option, absorb all National employees involved directly with the operation of the Production Unit or field. Subsequent Production Units of a Commercial Field or of any other field in the Contract Area shall be taken over by NNPC at any time after six (6) months from the commencement of Commercial Production from such fields provided NNPC shall give CONTRACTOR six (6) months notice of its intention to take over the operations.
> 9.2 NNPC may at its sole discretion retain CONTRACTOR or a third party to continue production operations on behalf of NNPC under an agreement separate from this contract.
> 9.3 During the period of transfer of a Production Unit to NNPC, both Parties shall work out and execute an effective handover programme to be completed within a period of six (6) months. During such period NNPC and CONTRACTOR shall jointly conduct the Production Operations under the overall charge of the CONTRACTOR".[117]

4.1. Mechanism used for reimbursement of the IOC:

As noted earlier, the IOC is paid all the costs it incurs with or without interest depending on the terms of the particular agreement. Comparatively speaking, this is similar to the cost recovery structure under PSCs. In addition, it is paid a service fee which is also comparable to the profit oil share.[118] Taking the Ecuadorian Contract as a starting point, both cost recovery and service fees are reimbursed in kind to the IOC out of the exportable balance of production. Article 21 of the Contract states that:

---

[117] Supra n.23, Supplement No. LXV (65) at p.25.

> "After the Production Phase has commenced in the Contract Area, CEPE shall reimburse the investments, Costs and Expenses at their historical value in U.S. Dollars, as affected (book value), and shall also pay the Service Fee for services rendered by Contractor pursuant to this Contract.........
>
> Reimbursements for investments and payments of the Service Fee shall be made in U.S. Dollars.
>
> ....CEPE and Contractor hereby agree that any investments made by Contractor during the Exploration and Exploitation Periods shall be reimbursed by CEPE in kind, and that CEPE shall also pay Contractor in kind for the Net Service Fee provided for hereunder. Such reimbursements and payments shall be taken from the Exportable Balance Applicable to this Contract, and such Exportable Balance shall in the first place be employed to satisfy such payments and reimbursements. CEPE shall deliver the Crude Oil allotted to Contractor hereunder at the export terminal, FOB Ecuadorian Port".[119]

This section goes on further to provide for the annual amount of the Service Fee which is quantified according to a determined formula[120] as well as the process of reimbursement of the IOC. Under the Nigerian RSC, the IOC is reimbursed from the proportion of production from each of the commercial fields. All payments for exploration costs are made without interest whereas payments for development costs are made with interest. Article 11.8 thus provides:

---

[118] Supra n.3, at p.248.

[119] Supra n.115, at pp.54-55.

[120] The annual amount of the Service Fee is quantified according to the following formula:
TS = PR (INA) + R (P-C) Q . Where:
TS = Annual amount of Service Fee payment in U.S. Dollars.
PR = Average Prime Rate,in decimal fractions,determined by the Central Bank of Ecuador on the basis of the Prime Rate established by major U.S. banks, pertaining to the monthly average of the applicable fiscal year.
INA = The sum of development and production investment incurred by contractor, less any reimbursements of such investments, accrued and paid out by CEPE to contractor, adjusted at the beginning of each fiscal year.

> "All costs and expenses properly made in accordance with the provisions of this Contract shall be reimbursed as follows,.....
>
> (a) NNPC shall reimburse Contractor for all costs of Exploration incurred by Contractor and no interest shall be payable thereon.
>
> (b) NNPC shall reimburse Contractor for all Development Costs properly incurred by Contractor and interest shall be payable thereon at the London Interbank offered rate (LIBOR).....per annum. The reducing balance method shall be applied in computing the amount of interest due and payable thereon.
>
> (c) Production Costs properly incurred by Contractor shall be fully reimbursed in Nigerian currency within thirty (30) days of the date of receipt of the relevant invoice by NNPC".[121]

It is to be noted that this particular Nigerian RSC reimburses the IOC for its services

---

R = Average factor, in decimal fractions, that shall guarantee a profit for contractor (this is estimated using a formula).
C = Production costs (not including Service Fee) plus transportation costs per production unit (pursuant to a definition provided for in the contract).
Q = Annual audited crude oil production from the contract area, in production units. See id., at pp.56-58.

[121] Supra n.3, at p.32. Article 11.9 provides for the method of reimbursement. All reimburseable expenditures incurred in the contract area other than production costs are reimbursed in quarterly instalments according to the formula:

$$Rq = \frac{Ec + Dc}{4T} + Id. \quad \text{Where}$$

Rq = Quarterly repayment instalment
Ec = Total exploration costs
Dc = Total development costs
Id = Product of the outstanding balance of development costs and one-fourth of the annual interest rate as of the last working day of the applicable quarter
T = Repayment period in years (7.5 years).

See id., at p.33.

by cash payment. However, by Article 11.13 of the agreement, the IOC has the right to take

> "....[c]rude [o]il won and saved in the [c]ontract [a]rea amounting to the greater of (a) 50% of the total volume of such [c]rude oil (or amount equivalent in value of crude available to NNPC from other producing areas in Nigeria) or, (b) the equivalent in value to the total payments due contractor from NNPC for reimbursement and remuneration for the relevant quarter. To the extent of such total payments due [contractor] from NNPC, [c]rude oil taken by [contractor] shall be considered to be in lieu of cash payment to [c]ontractor......"[122]

It would appear that there are various methods used in computing the amount to be paid to the IOC for the rendering of services to the HC. It is prudent that the parties use very simple straight forward methods in devising a cost formula in order to avoid difficulties that might arise in the computation of the amount reimburseable to the IOC.

The RSC also generally subjects the IOC to the tax laws of the HC. The IOC pays income tax and other taxes due on its remuneration, or on its share of the petroleum. Under the Nigerian contract, customs and other duties levied as a result of the IOC's activities are reimbursable. The tax regime of the agreement under consideration is to the effect that:

> "17.1 Customs duties and other duties levied on imports and services by reason of CONTRACTOR'S activities in performing Exploration, Development and Production Operations hereunder shall be regarded as Exploration Costs, Development Costs and Production Costs, as the case may be and shall be reimbursed to CONTRACTOR in the manner provided for in this Contract.
>
> 17.2 Taxes due on the Contractor's remuneration, in accordance with Company Tax Act shall be borne by the CONTRACTOR, and shall

---

[122] Id., at p.35.

not under any circumstances be reimbursable to CONTRACTOR.[123]

This tax regime is typical of most RSCs entered into between IOCs and HCs although their formulation may vary from one contract to another.

4.2. An Assessment:

The RSC seems to be restricted to oil rich countries with a strong bargaining position. It has rightly been observed that the RSC, represents an attempt to procure the services of the IOC while at the same time it gives meaning to the HC's sovereignty over its natural resources.[124] As we have seen from the features of the RSC, the scope and object of the contract is clearly stated to be the performance of services, which are exhaustively defined in the contract. The provision relating to ownership rights is compendiously defined to avoid any doubts. The HC exercises control over all basic decisions crucial to the operations. It also receives a higher return from the project since all the profits accruing therefrom go to the HC. These provisions are commendable as they represent a concrete attempt at translating into action the principles of permanent sovereignty. They should be viewed in the context of the HC striving to achieve an equitable relationship in the exploitation of its natural resources.

Additionally, from the HC's perspective, this contractual mechanism is employed not only to enlist the services of the IOC but it can also be seen in terms of providing the necessary risk capital for petroleum development.

It would seem that the RSC appears to be favourable to the HC. Its terms are simple and straight forward. Most of these contracts are of a short duration. This should directly encourage the IOC to intensify its exploratory and development efforts "early in the day", in order to recover its expenses as fast as possible if a commercial discovery is made.

---

[123] Id., at p.43.

[124] Supra n.3, at p.97.

From the IOC point of view, as noted in chapter two, access to secured supplies of crude oil to service their downstream operations is an important factor in their world-wide operations. The IOC would therefore prefer contractual arrangements that reimburse it in kind for its services. In structuring RSCs, provisions for reimbursement must take account of this factor. It is suggested that, since reward for services by cash payment only may not be attractive to the IOC, a clause in the nature of payment partly in cash and partly in kind is desirable. This would be a fair means of accommodating the interests of both parties.

Studies indicate that the RSC finds its widest use in countries where the IOC considers its exploration risk to be relatively small and the potential discoveries to be substantial.[125] This contractual mechanism may therefore not be an attractive one for IOCs, especially in countries where the size of possible reserves tend to be smaller. The result of this would be that countries wishing to use this contractual device would have to adjust its terms to a greater extent to suit the IOC. In regard to payment for the services of the IOC for example, one writer suggests that:

> "[t]he conditions for reimbursing the general contractor for all expenses incurred for exploration in case of discovery of oil, along with the development funds and interest calculated upon it, should be abolished and substituted by the following formula:
>
> - A fixed discount of x% of the international market

---

[125] Supra n.6, at p.55.

> price for certain quantities of oil to be produced and sold to the general contractor shall be granted, plus - The right to a secured oil supply at the international market price for a number of years to be agreed upon by both parties."[126]

In his opinion, therefore, the IOC will be expected to recover a fixed discount of X% of the international market price of the oil produced,in addition to a guaranteed supply of oil at the international market price for a stated number of years agreed upon by the parties. This arrangement would be fair and sufficient to compensate the IOC for the risk taken,the expenses incurred and the services rendered.[127] This suggestion would be greatly welcomed by the IOC and act as an incentive for oil exploration in HCs given the point made earlier on about the global operation strategy of the IOC. The problem here is that the acceptability of this suggestion by IOCs will depend on favourable market conditions. In situations where the international market price of oil is very low, an IOC will prefer to receive its remuneration in cash for the services rendered. Additionally, it will seem favourable to IOCs only if they are sure of finding oil in substantial quantity. From the HC perspective, the dilemma here is that those countries embarking on oil development for the first time, with the intention of satisfying to a large extent their domestic consumption needs, may find this too onerous. In any case, where the RSC is used as a contractual device, HCs faced with this situation may deal with the smaller IOCs which have no integrated operations. Such companies would have no difficulty taking reward for their services by cash payment.

---

[126] Al-Ani T.F., "Viewpoint on the Service Contract for Exploration, Exploitation and Marketing of Oil" (1977) 1:4 OPEC Review 32 at p.35.

[127] Ibid.

Lastly, since the profits of the IOC are limited under the RSC, many companies may not prefer this device, especially where it may have adverse effects on their contractual arrangements elsewhere.[128] The appropriateness or otherwise of the RSC seems to hinge on a number of factors, the most significant of which are "the likelihood of finding oil and the size of possible reserves, the particular supply/demand position of crude oil of specific companies, and the knowledgeability and sophistication of the Government in seeking out such arrangements".[129]

5. Participation Agreements

The Participation Agreement (PA) stricto sensu is not a separate form of contract. It combines features of the agreements described earlier. The emphasis here is on the mode of participation by the HC. Under the concession and PSC, the HC and the IOC maintain separate entities. In contrast, the PA is in the nature of a partnership arrangement whereby the HC through its NOC forms a joint operating company with the IOC to develop the host state's petroleum resources.[130] This usually takes place at the development phase rather than at the exploration stage. The HC normally shares the risks,[131] costs, production and profit with the IOC according to the terms of the agreement. The entity thus formed is operated by a management committee made up of representatives from both the HC and the IOC.

---

[128] Supra n.6, at p.56.

[129] Ibid.

[130] For a historical account of the evolution of Participation Agreements in the Middle East and Egypt for example, see Stevens P.J., Joint Ventures in Middle East Oil (1976) at Chap.2;Ely N., "Changing Concepts of the World's Mineral Development Laws" in Proceedings of the International Bar Association Seminar on World Energy Laws, held in Norway, May 1975 at pp.28-32.

[131] The IOC alone normally bears all the risk of exploration, geophysical work and drilling until the commercial discovery stage.

In the main, the PA is an instrument for the acquisition of technical and managerial skills in petroleum undertakings by the HC. By having representation on the management or operating committees, the HC through its NOC directly takes part in the most important decisions affecting petroleum operations in its territory. Additionally, by its direct involvement in the conduct of operations, the NOC builds up the necessary local expertise to eventually undertake petroleum development on its own. This seems to be the rationale behind some provisions of the PA, which have the effect of transferring operations to the NOC once the IOC has recovered all of its capital investment. It has been described as merely adding a new element to an international petroleum contract rather than being a substitute for one.[132]

The PA defines and contains extensively all the terms and conditions under which the joint enterprise operates. A model Association Agreement between L'Enterprise Tunisienne d'Activités Petrolières (ETAP)[133] and Private Companies for example, states in its Article 2 that:

> "The object of the present Agreement is to define the conditions under which the Parties intend to carry out joint exploration, development and exploitation of the fields of mineral substances......., as well as the processing and transport of these substances".[134]

There are different approaches to the form and extent of participation under the PA. These may either be fixed, gradual, or optional. Where participation is fixed, the HC and the IOC share the risks of the occurrence of commercial discovery, as well as a given percentage of production which is stated under the contract. To illustrate this more vividly, the Tunisian example states in its Article 3 that:

---

[132] Supra n.3, at p.100.

[133] ETAP is the national oil company of Tunisia.

[134] Basic Oil Laws and Concession Contracts - North Africa (Original Texts) (1986) Supplement No.LXXIV (74) at p.59.

> ".......,the Parties will form an association (hereafter called "Association") which is an unincorporated body whose objective is to carry out the operation foreseen in Article 2 above. The participation percentage of the Parties in the Association is as follows: .....% ETAP and .....% for.... . Unless otherwise stated..., the following conditions apply;
> 3.1. Each Party shall bear, in proportion to the above-defined participation percentage, all operational costs and expenditures relating to the development and exploitation,and incurred in virtue of the present Agreement.
> 3.2. In proportion to its participation percentage defined above, each party holds all property and interest acquired in virtue of the present Agreement and assumes the responsibilities deriving from said Agreement".[135]

A gradual participation involves an increase of that percentage initially provided for under the contract. This usually happens where there is an increase in the level of production. The optional participation scheme vests a discretion in the HC under the contract to determine its percentage participation, as and when,it deems it fit.[136] HCs, however, normally opt for participation after the determination of a commercial discovery.[137]

The substantive rights and obligations of the parties under the PA are similar to the contractual forms already examined, and the PA contains the usual provisions to be found in any international petroleum agreement. We shall therefore proceed to consider here the mechanism of operation under the PA.

Most PAs entrust to the IOC the daily operations of the venture. The IOC, however, performs such duties on behalf of the parties. In some cases, the IOC and the NOC jointly carry out the operations. The scope of such duties can be seen from the Tunisian contract thus:

---

[135] Id., at pp.59-60.

[136] Ibid.

[137] Ibid.

> "4.2. The operator, on behalf of the Parties, is entrusted with the performance of all exploration works, development and exploitation operations of the mineral substances ......as well as the processing and transport of these substances".[138]

Even more elaborate in its scope is a 1980 Madagascar model Partnership Agreement between Akorama[139] and Oil Companies, which states under its Article 5 that:

> "5.1.1. Within the framework of the general directives given by the management committee and the provisions of this agreement, the operator is responsible for the conduct of the work and operations undertaken by the partnership.
> 5.1.2. The operator conducts the operations in the best technical conditions of efficiency and cost, and implements all the appropriate means in view of the execution of the programs in the best technical and economic conditions, according to good practice and the standards generally accepted in the international petroleum industry.
> 5.1.3. The operator is required to comply with the terms of this agreement and the prescriptions of the mineral title, and to observe the provisions of the laws and regulations in force.
> The operator agrees to:
>
> > -give priority to local materials and personnel, in equal conditions of quality and qualification, in the conditions of cost provided by the local legislation and regulations in force;
> > -supply sufficient performance bonds as to his execution of his contractual obligations".[140]

In order to ensure the implementation of provisions of the contract, and participation in decisions affecting the future course of operations, a joint operating or management committee is usually formed. This committee consists of representatives of both the NOC and the IOC. Its composition normally varies depending upon the participating interests of the respective parties. Article 4 of the Tunisian contract provides as follows:

---

[138] Supra n.134, at p.63.

[139] This is the NOC of the Republic of Madagascar.

[140] Basic Oil Laws and Concession Contracts - South & Central Africa (Original Texts) (1981) Supplement No.LXIII (63) at p.28.

> "The studies and operations, agreed upon by an Operating Committee, will be carried out directly or indirectly by the Operator as indicated below:
>
> 4.1.1. The Operating Committee is composed of an equal number of representatives designated by ETAP and...... . The presidency of the Operating Committee is ensured by the operator.
>
> 4.1.2. The Committee is responsible for making the decisions concerning all operations and works of the Association and, in particular:
> -to establish the operations and work programs and the pertinent budgets;
> -to approve the nature and organisation of all works;
> -to approve all contracts and offers proposed by the Operator which amount to more than 100,000 Tunisian Dinars or whose annual commitment exceeds 50,000 Tunisian Dinars;
> -to examine activity reports prepared by the Operator and to check his conduct and execution of the works entrusted to him;
> -to establish the production programs following examination of the proposals submitted by the Operator;
> -to approve the accounts of the Association submitted by the Operator;
> -to approve any proposals by.....or, failing its proposal, to accept ETAP's proposal to file, within the legal deadline of 30 days, all renewals, relinquishments, concession applications regarding the leases held or to be held by the Association;
> -to decide upon the surrender of information to third parties and to define the pertinent conditions ".[141]

Again, for purposes of illustration, the Madagascar contract model provides a clear picture of the composition, powers and voting procedures used under the PA. Article

---

[141] Supra n.134, at pp.60-61.

4 of the Agreement, which is very far-reaching in its provisions states:

> "4.1.1. The Management Committee is the commanding and coordinating agent of the partnership.
> The management committee is composed of:
> -3 representatives of the AKORAMA,
> -2 representatives for the companies.
> Equal representation may eventually be considered.
>
> 4.1.2. The management committee is presided over by 1 representative from the AKORAMA.
>
> 4.1.3. The management committee can, as needed, be assisted by a number of experts agreed upon by the parties. The experts have no vote.
> 4.1.4. The AKORAMA and the Companies each designate their official representatives and substitutes for the latter in case of absence. Each official representative or substitute can also give any of the other representatives or substitutes the power to represent him to the council. The official representative is responsible for informing the substitute.
>
> 4.2. The partnership is directed by the management committee which has all the rights and powers for this purpose. In particular the management committee makes all decisions relative to, but not limited to, the following:
> a) examination, approval or modification of the overall exploration and exploitation program proposed by the operator;
> b) examination, approval, or modification of the programs and budgets proposed by the operator;
> c) recognition of the commercial character of a discovery and delimitation of the areas which will be placed in exploitation;
> d) auditing of the Operator's accounts and monitoring and execution of the work;
> e) examination of the terms relative to the satisfaction of the local market upon removal from the field by each partner of his share of the crude oil;
> f) examination and approval of the mandatory and voluntary returns proposed by the Operator;
> f) examination, approval or modification of the proposals made by the Operator regarding applications for the renewal, extension or abandonment of the mineral title.
>
> 4.3. Each partner has voting rights corresponding to his percentage of interest. This voting right is exercised through his representative(s) on the management committee.

> All the decisions of the management committee are made by a 3/4 majority of the percentages of interest except for decisions relative to:
> - the commercial nature of a discovery;
> - the waiver;
> - the increase of the budget;
> - the suspension of operations;
> - the replacement of operators, which must all be made unanimously".[142]

One interesting feature of PAs which cannot be overlooked is the issue of training of local personnel and the transfer of technology.[143], Most of the agreements contain provisions to that effect, designed for the eventual take-over of operations by the HC. The Implementing Agreement of 1977 relating to the Participation Agreement between Abu Dhabi National Oil Company (ADNOC), British Petroleum Company Limited (BP), Compagnie Francaise des Petroles (CFP) and Japan Oil Development Company Limited (JODCO) states in its Article 3 that:

> "3.01 ADMA-OPCO [Abu Dhabi Marine Operating Company] shall follow an active policy of hiring personnel in order to ensure the development of its own staff ...
> 3.02 In implementing its policy of hiring personnel, ADMA-OPCO shall abide by the Government's policy of Arabisation by recruiting, by preference, nationals of the U.A.E, followed by other Arabs,.......
> 3.03 In order to facilitate and expedite the implementation of the above-mentioned Arabisation policy in the Company, ADMA-OPCO shall conduct appropriate training schemes designed to prepare U.A.E. nationals for employment and advancement in the company. For this purpose ADMA-OPCO shall submit annually a programme of training and development for its U.A.E. employees to the JMC for approval".[144]

---

[142] Supra n.140, at pp.26-27.

[143] We shall consider the trends generally in economic development provisions under international petroleum contracts in the next chapter.

[144] Basic Oil Laws and Concession Contracts Middle East (Original Text) (1987) Supplement No. XCIII (93) at P.23.

5.1. An Assessment

As indicated at the beginning of this section, PAs are strictly not a separate form of contract. Participation can take many forms and can be achieved in conjunction with the other three contractual types we have described.[145]

The use of the PA as a contractual mechanism enables the HC, through the vehicle of the management committee to exercise direct control over petroleum operations.

It is appropriate here to point out one main drawback of the participation scheme when used within a risk-service contract or a production-sharing arrangement. The problem is that, the legal status of the HC does not become clear. The HC may have the status of a "contractor" while at the same time it retains the IOC as contractor which does not make for a clear sharing of responsibilities.[146] An example of this type of situation is to be found under the PERTAMINA PSC, where it becomes difficult to draw the line between the responsibilities of the IOC vis-a-vis the HC. The suggestion has therefore been put forward that the concession arrangement is most suitable where the HC seeks participation, since it can share equal rights to production based on the respective shares of interest of the parties.[147]

One word of caution for HCs is that, in seeking participation they must realise that it is still possible to exercise a greater degree of control over their oil resources without having a large equity stake.[148] Lack of the necessary capital for development is characteristic of developing countries. Thus, it will not be a wise option for these countries to make heavy commitments in terms of financing oilfield development, since they will have to finance their share of imported capital equipment.[149] In the final analysis, participation arrangements must be structured in order to achieve objectives which the HC has clearly identified by such participation.[150]

---

[145] See supra n.3, at p.118.

[146] Id., at p.119.

[147] Ibid.

6. Concluding Remarks:

There is no attempt in this chapter, to prescribe a blue-print type contract which will be suitable for host developing countries.[151] What is important to bear in mind is not the type of contract a HC may enter into with an IOC.[152] The terms of the contract entered must be of the utmost importance. These should be structured in a way that is acceptable to both parties.

It should be pointed out that the distinctions between the main contractual types are helpful conceptually.[153] It enables us to distinguish the various contractual types used in the international petroleum industry. In practical terms however, HCs do not necessarily have to adhere to contractual stereotypes.[154] The proportion of costs, profits and crude oil to be allocated to the IOC and the HC respectively and how these will vary overtime is important. Also, attention needs to be focused on the pace and character of the development of the oil resources of the HC.[155] Different provisions from the contract types discussed can be merged in one arrangement to transform it into one that meets the legitimate expectations of the parties. An example of this is the contract used by China in their first licensing round in 1984.[156] That model contract contained provisions drawn from production sharing agreements, service contracts and participation agreements.[157] It is possible for example, to provide for increasing HC participation in management decisions under the concession system, as under any of the other systems or to incorporate some features of the fiscal regime under PSCs into service contracts. The resource rent tax has proved to be a useful fiscal mechanism for HCs to capture any excess or "windfall profits" that go to the IOC. It is not applicable until a certain threshold level of profitability has been attained. Its use will therefore not have any disincentive effects. HCs should thus encourage its use under any contractual mechanism employed. The main approaches taken by HCs has been the wide use of the modern concession contract especially by the Middle Eastern countries. In Abu Dhabi for example, improvements have been made to the concession to achieve HC objectives. These are related to an increase in "government take" through, among others, higher royalties, excess profit tax and better control of petroleum activities by the introduction of state participation.[158] Also Papua New Guinea has improved its concession with the introduction of the resource rent tax.

---

[148] Supra n.29, at p.32.

[149] Ibid.

[150] Ghadar F., "Political Risk and the Erosion of Control: the Case of the Oil Industry" in Khan K.I.F. ed., Petroleum Resources and Development - Economic, Legal and Policy Issues for Developing Countries (1987) at p.108.

[151] See supra at p.83.

[152] See Le Leuch H., "Recent Evolution of Petroleum Exploration and Exploitation Agreements in Developing Countries: New Approaches to Introduce more Flexibility and Progressivity in the Contracual Terms"(1986) Natural Resources Forum 205 at p.214.

[153] Smith E.E., Typical World Petroleum Arrangements (Paper delivered at the Rocky Mountain Mineral Law Foundation seminar on International Resources Law: A Blueprint for Mineral Development, Feb.18-19,1991) at p.9-42.

---

[154] To cite an example of practical importance, it was found in a study of sixteen different petroleum fiscal systems that the contract forms used was not a crucial variable in the determination of financial benefits from oil production. See Kemp A., & Rose D., "Investment in Oil Exploration and Development: A Comparative Study of the Effects of Taxation" University of Aberdeen, Department of Political Economy, North Sea Study Occasional Paper No.18 (1982) cited in supra n.54, at p.82 footnote 16.

[155] Tanzer M., "Negotiation Strategies and Objectives in Petroleum Exploration and Development Agreements" in U.N. ed., Exploration Strategies in Developing Countries (1982) at p.218.

[156] See, ibid., citing Frihagen A., The Chinese and Some Developing Nations' License Regimes (7th Solstrand Oil and Gas Law Conference:University of Bergen 1984.)

[157] Ibid.

The PSC has been used in more than 30 host countries including Indonesia, Malaysia, Angola, Egypt, Gabon, Libya, Ivory Coast, Sudan and Tanzania. More recently countries such as Kenya and Ghana have used the PSC where taxes are levied and production sharing based on a sliding scale related to rates of return.[159] There has been a marked trend in some countries to prefer the PSC over the concession arrangement.[160]

RSCs have been used mainly in South America. Nigeria has also experimented with this contract type by providing for shorter durations. The IOCs pay all funds necessary for exploration and development and also any other obligations assumed under the contract. The absence of a clearly formulated energy policy has however hampered the smooth operation of the RSC in that country.[161] There are however some basic clauses that cannot be ignored in whatever arrangement is chosen. Provisions for employment of local nationals and training, transfer of technology, meeting the domestic crude oil supply requirement of the HC are but a few. There must be close supervision, constant monitoring of work programs, strict performance requirements and other related issues to make sure that the basic objectives sought to be achieved under a particular contract are realized. The particular details of any contract must be worked out and tailored to the particular circumstances of the HC. The contract regime must provide for different degrees of control over the project, participation, risk assumption, ownership of crude and share of profits.

---

[158] Le Leuch H., "Recent Evolution of Petroleum Exploration and Exploitation Agreements in Developing Countries: New Approaches to Introduce more Flexibility and Progressivity in the Contractual Terms (1986) 10 Natural Resources Forum 205 at p.211.

[159] See supra n.54, at pp.83,87.

[160] Supra 158., at p.212.

In sum we have examined the main contractual types prevalent today in the international petroleum industry, in terms of their advantages and disadvantages. A combination of the main contracts discussed or the evolution of any new contract forms in the industry must be a positive sign towards reconciling various interests.[162]

It is suggested that, a suitable contract regime tailored to the needs of each country cannot be realized by strict adherence to labels. It is hoped that if attention is focused on some of the issues we have discussed in this chapter, the parties to the international petroleum contract will begin to realise the merits inherent in the substance of contractual provisions which would be designed to achieve the desired results from the standpoint of both parties.

---

[161] See Omorogbe Y., "The Legal Framework for the Production of Petroleum in Nigeria" (1987) 5 Journal of Energy and Natural Resources Law at pp.273-290.

[162] U.N.C.T.C., Transnational Corporations in World Development - Trends and Prospects (1988) at p.323.

CHAPTER 5

RELEVANT CONSIDERATIONS PERTAINING TO SOME CLAUSES OF THE INTERNATIONAL PETROLEUM AGREEMENT

1. Introduction:

International Petroleum Agreements (IPA) are a genre of economic development arrangements[1] that give rise to a wide range of issues. These agreements, as already noted, are of long term duration. The parties to the contract must therefore exercise the greatest caution to include terms or provisions devoid of any major ambiguities. Petroleum development in HCs must take place within a suitable legal environment. The legal techniques employed in drawing up a contract must be capable of providing an adequate mechanism through which the HCs will receive the necessary flow of investments whilst at the same time retaining control over their resources.[2]

---

[1] These agreements have variously been labelled as "concessions", "international contracts", "investment agreements", and "development agreements". Each of these names emphasise a particular characteristic of the agreement. See Arsanjani M.H., International Regulation of Internal Resources (1981) at p.179. Essentially, they are long term investment agreements between a state (usually a developing country) and a foreign corporation for the exploitation of the former's natural resources, or directed at other objects bearing on the development of that country's economy. It has an important technical assistance impact. Lord McNair describes the economic development agreement as "contracts....entered into for many purposes and bearing names. Amongst the purposes may be mentioned the development of oil or other mineral resources; the laying of pipe-lines for oil; the development of an uncultivated area for the purposes of agriculture or forestry, & c. Perhaps they are best described as 'economic development agreements'. They are often called 'concessions', but the objection to this term is that it is apt to conceal the bilateral character of the transaction, and moreover it is often used, popularly to denote the area in respect of which the agreement is made". McNair, "The General Principles of Law Recognized by Civilized Nations" (1957) 33 British Yearbook of International Law at p.1; See also, Ijalaye D.A., The Extension of Corporate Personality in International Law (1978) at pp.147-154; Cherian J., Investment Contracts and Arbitration (1975) at pp.16-17; Farer T.J., "Economic Development Agreements: A Functional Analysis" (1971) 10 Columbia Journal of International Law at pp.200-241.

[2] Date-Bah S.K., "The Legal Regime of Transnational Investment Agreements that is Most Compatible with both the Encouragement of Foreign Investors and the Achievement of the Legitimate National Goals of Host States" (1971) 15 Journal of African Law at p.241.

Traditionally, one of the controversial aspects of IPAs has concerned various attempts to deal with changing circumstances. Some techniques, such as stabilization clauses, seek to guarantee the continuance of a particular regime throughout the life of the contract. The issue of stability over the entire life of the project must be of paramount concern for the contract regime to be effective and fair. Other provisions that also deal with issues of change in the contract regime are modification clauses dealing with force majeure and hardship. In addition, a governing law clause can have an indirect effect on contractual changes. These clauses will be discussed in this chapter to indicate differing approaches to dealing with changing circumstances. The discussion is preceded by an examination of the characterisations of nature of the international petroleum agreement - whether they are private or public contracts, and secondly whether they should be treated as international or domestic contracts . This can also affect the manner in which an agreement deals with changed circumstances, for some characterisations can increase the flexibility of the IPA, while others result in greater rigidity. The chapter closes with an appraisal of issues that must be addressed, in seeking a modicum of stability while still allowing flexibility in the face of changing circumstances.

2. The legal nature of International Petroleum Agreements:

The issue here is to determine whether the IPA is in the nature of a commercial transaction governed by principles of private law or whether it belongs to the domain of public law. This is important in determining the extent to which the HC is entitled to modify or abrogate the manner and conditions of performance of the contract. There are diverse opinions on the precise legal nature or status of the

IPA.[3] This problem exists perhaps because of the varying methods used by different legal systems to express the relationship between the IPA and the relevant legislation on one hand, and on the other the different forms of petroleum arrangements in use in the industry.[4] Basically, the IPA is concluded between a state or its NOC and a private foreign investor and sets out the rights and duties of the parties which they must honour as we saw in chapter 4. There is no doubt that the legal document which is executed between the government and the foreign private investor is in the nature of a contract.[5] The agreement thus concluded normally gives rights to the latter to explore for, develop and produce the petroleum resources of the HC in return for payment. From another point of view, the strong regulatory element involved in the grant, form and conditions of rights to explore for petroleum makes the transaction one that falls within the domain of public law.[6] Rights in petroleum in most legal systems are vested in the state on behalf of its citizens, and it is only with the permission of the state that these resources can be exploited. Once these rights are granted, the state exercises a considerable degree of control by legislation. This will normally regulate the activities of the private investor - for example, setting forth the conditions of the grant, operational, health and welfare standards which must be adhered to. Also, in most cases, the HC is empowered to supervise or control the operations of the other party.

---

[3] Fabri N., "The Legal Nature of Petroleum Agreements: A Comparative Analysis" (1986) Australian Mining and Petroleum Law Association Yearbook 1 at p.12.

[4] Toriguian S., Legal Aspects of Oil Concessions in the Middle East (1972) at pp.63-66.

[5] See the decision rendered by the Arbitration Tribunal in Texaco v. Government of the Libyan Arab Republic (1979) 53 International Law Reports 389 at pp.438-439. The Tribunal stated that "....from a formal point of view and prima facie, the Deeds of Concession in dispute were of a contractual nature since they expressed an agreement of the wills of the conceding state and of the concession holders. Furthermore, the Deeds of Concession corresponds to the standard accepted both by international practice and by international theory".

[6] Supra n.3, at p.13; For a discussion of the public law relationship between the state and private investors under Italian Law for example, see, Nicolazzi M., "Petroleum Law and Petroleum Joint Ventures in Italy" (1980) 8 Journal of Energy and Natural Resources Law 30 at pp.31-36.

Essentially, the IPA represents a commercial transaction setting out the rights and duties of the parties. The agreement regulates the relationship in a manner that is similar to an ordinary contract. In another vein, the agreement possesses elements of public law which one does not find in private contracts.[7]

The views and opinions of legal writers,[8] mainly from the capital exporting countries, have been to analyse the elements of private and public law which are invloved and determine whether the latter obliterate or dominate the contractual character of the IPA. They claim that the public nature of the petroleum contract shares similar characteristics with other forms of alienation of state resources under ordinary contracts. The only difference between petroleum contracts and ordinary contracts is that, in the former, the alienation does not occur in one single operation but involves a long-term relationship between the parties.[9] The point is made that the IPA is a species of private contract and therefore subject to all the traditional rules and concepts applicable to contracts entered into between private persons.

To buttress the claim that IPAs are species of private contracts they argue, firstly that, the fact that the terms and conditions of the contract are determined in advance by the state (for example, where model contracts are used) does not alter the contractual nature of the agreement. A distinction between the legal nature of an IPA, where the terms and conditions are statutorily or administratively determined and one whose terms and conditions are negotiated and settled by the parties is not justified. In both situations the contract comes into existence by the mutual agreement of the parties. It has also been said that the drafting in advance of the conditions of the contract by the government may be an obligation imposed upon them by law, but it does not deprive the transaction of its essential contractual character.[10]

---

[7] Ibid.

[8] See for example, O'Connell D.P., The Law of State Succession (1956) at p.107; Jennings R.Y., "State Contracts in International Law" (1961) 37 British Yearbook of International Law at p.156; Schwebel S.M., "International Protection of Contractual Arrangements" (1959) Proceedings of the American Society of International Law (53rd Meeting) at p.266.

[9] Supra n.3, at p.13.

Secondly, the grant to the petroleum company of special rights, privileges and facilities does not change the nature of the agreement. This concession by the HC to the IOC is in consideration of the latter's potentially huge investment in the development of the petroleum resources of the HC. It represents the HCs contribution to the success of the venture.[11]

Thirdly, a comparison is drawn between the IPA and other government contracts (such as building and work contracts) which have a strong regulatory element. The question whether other government contracts are public or private however, has not given rise to much controversy.[12]

Finally, it is said that the legislative approval which is prescribed for the grant of the right to explore for petroleum resources does not alter the contractual character of the agreement. Legislative approval is required, in some countries, for certain categories of contracts entered into by the government for example, contracts for public loans. Whether or not legislative approval is required for the approval of the IPA, the IOC has the freedom to accept or refuse it. Where it is accepted and the contract comes into force, there is a union of wills between the parties, and this presents all the characteristics of a private contract.

---

[10] Ibid.

[11] Ibid.

[12] See, Turpin C., Government Contracts (1972).

The conclusions drawn from the above summary are that the elements of public law which exists in an IPA do not eclipse the basic contractual and commercial character of the transaction. The IPA is therefore a form of private contract entered into on the basis of free will of the parties. It is subject to all the rules and concepts that are applied to contracts between private parties.[13] O'Connell, for example, concedes the difficulties involved in the categorisation of the IPA - the issue of whether its private or public aspects predominate. He nevertheless concludes that the interest acquired by the private investor is one governed and protected by private law.[14] The implication of subjecting the IPA to private law notions is that contracts duly entered into must be kept and performed in good faith. The pacta sunt servanda rule thus applies not only in the relations between private persons but also between private persons and states. According to Fabri, the results of subjecting the PA to strict private law notions would be that the transaction is regarded:

> ".....as a static model representing a 'definitive' deal: a fixed regime of rights and obligations, impositions and benefits which does not admit

---

[13] Id., at p.14.

[14] O'Connell D.P., supra n.8.

> of variation and alteration throughout the terms of the agreement. Accordingly, any departure from contractual terms, in the form of unilateral modification or abrogation by the state, is regarded as an act violating the principle of sanctity of contract or the binding force of contractual terms".[15]

The importance of contractual flexibility cannot be over-emphasised. It is obvious that a rigid regime of contractual terms is not in the best interests of both parties.

The other view put forward by legal writers,[16] mostly from developing countries, gravitates towards notions of treating the IPA as lying within the province of public law. The reasons proffered are that the HC should serve the social and economic needs of its citizens through the exercise of its legislative and administrative powers. The IPA, therefore, forms an integral part of the economic developmental processes of developing countries and contracts entered into must be shaped by the public policy objectives of the state. The transactions concluded would be subject to changed economic conditions and the general expectations of the public. In sum, the IPA is viewed as having the same characteristics as public contracts called contrats administratifs or administrative contracts.[17] These contracts are to a greater extent governed by a special set of public law rules which correspond to needs arising from their particular nature and objectives.[18]

---

[15] Supra n.3, at p.16.

[16] See for example, Mughraby M.A., Permanent Sovereignty over Oil Resources (1965) at p.174 ; Suratgar D., "Considerations Affecting Choice of Law Clauses in Contracts between Governments and Foreign Nationals" (1962) 2 Indian Journal of International Law at p.273; Toriguian S., supra n.4, at Chap. 1; Rouhani F.A., A History of OPEC (1971) at p.272; El-Kosheri A.S., & Riad T.F., "The Law Governing a New Generation of Petroleum Agreements: Changes in the Arbitration Process" (1986/87) ICSID Review-Foreign Investment Law Journal at p.260.

[17] For a discussion of the concept of Administrative Contracts in French Law (where it originated) within the context of economic development arrangements, see for example, An T., "The Law applicable to a Transnational Economic Development Contract" (1987) 21 Journal of World Trade Law 95 at pp.100-106; Toriguian S, id., at pp.18-21.

If the administrative contract concept is applied to the IPA, the state is endowed with rights to modify or amend the terms of the contract in the public interest. Geigher for example, suggests that administrative contracts as developed in the French system adequately and carefully weigh the conflicting interests of the parties. He concludes that administrative contracts should be analogously applied to economic development agreements.[19]

Other writers[20] have characterised the IPA as contracts sui generis, or subject to a mixed system of private and public law. State prerogatives flow from public law rules and the right of foreign investors is rooted in private law.

It would appear that though there is a strong public law element in so far as the IPA is concerned, one cannot rule out the private law elements present here. It is suggested that the public law elements seem to predominate over the private law elements on closely examining the terms of the agreements. These agreements cannot be understood as a rigid scheme of rights and duties. They are of prospective character and therefore must provide a degree of flexibility.[21]

---

[18] El-Kosheri A.S.,& Riad T.F., supra n.16, at pp.261-263.

[19] Geigher R.,"The Unilateral Change of Economic Development Arrangements"(1974) 23 International and Comparative Law Quarterly 73 at p.102. Arsanjani, contrary to this view suggests that the administrative contract idea is vague and that no definite or generally accepted criteria distinguish it from other state agreements. He concludes that the idea of unilateral modification or termination of the contract by the state is only a strategy to protect the national interests of its people. See Arsanjani M.H., International Regulation of Internal Resources (1981) at pp.197-198.

[20] See Cattan H., The Law of Oil Concessions in the Middle East and North Africa (1967) at p.30; Barraz P., "The Legal Status of Oil Concessions" (1971) Journal of World Trade Law 109 at pp.611-617; Fatouros A.A., Legal Guarantees to Foreign Investors (1952) at p.214; Ijalaye D.A., supra n.1, at p.153.

[21] Geigher R.,supra n.19, at p.104.

Importantly, certain public law rules should be applied to the IPA. The effect of applying public law rules will be that the consensual character of the contract is qualified by the attribution to the HC of powers whose true basis is public policy rather than the agreement of the parties.[22] The HC therefore has powers to modify or revise the terms of the contract in light of changing circumstances during the life of the project. This does not mean that private contract law rules should be entirely excluded. They can be applied within the necessary limits depending on the terms of a particular agreement. In sum it is suggested that each contract should be carefully examined, in terms of its predominant characteristics and the appropriate interpretation given it.

If we consider the IPA as predominantly belonging to the domain of public law then changed conditions and the general welfare of the public permits the HC to act in bringing about changes in the legal regime through the exercise of its sovereign powers.

Another aspect of characterising IPAs is whether they should be treated as international or municipal contracts. The fundamental precept of treating the contract at the international level is to seek certain guarantees for IOCs in order to obtain maximum security for their investment. Clauses providing for legislative stability, international arbitration, choice of law, promises of non-expropriation and non-interference are but some of the means through which IOCs seek to achieve these goals. The goal of these stipulations has been to subject contracts to traditional notions of international law. To ensure that the contract regime remains stable throughout the life of the project the principle of pacta sunt servanda is invoked, in order to require states to conform to obligations assumed under the contract. The claim that the principle applies to economic development arrangements involves the assimilation of petroleum contracts to treaties. The sanctity and immutability of these contracts is therefore ensured.[23] Any unilateral modification or termination of the agreement by the HC is regarded as a violation of the principle and contrary to international law.

---

[22] Turpin C.,"The Law of the Contract" (1982) 7 International Encyclopedia of Comparative Law 27 at p.28.

It should however, be noted that the substantive content of an international set of rules applicable to the contract, assuming this is desirable, is in itself controversial. One has to consider the parallel principle of clausula rebus sic stantibus. This allows for adjustment and termination of the contract in case of a change of the fundamental conditions on which the agreement was based. HCs may thus rely on this principle to bring about renegotiation or revision of the terms of the agreement in the event of changing circumstances.

The long term nature of international petroleum agreements makes it very difficult to predict with any certainty that the contract regime envisaged by the parties will remain the same. The regime must be based on a continuous process of revision and redefinition of the relations when circumstances require. Such an approach will constitute a departure from a strict insistence on traditional doctrines of international law such as pacta sunt servanda.[24] It is suggested that there is need for compromise among the parties, legal writers and arbitrators as to the precise nature of 'internationalisation' of the IPA. If the term is understood to include not only traditional international law doctrines but also the U.N. sponsored resolutions on permanent sovereignty over natural resources and concepts favouring revision, then we shall be witnessing a new era in petroleum regimes.[25]

---

[23] Sornarajah M., "The Myth of International Contract Law" (1982) 16 Journal of World Trade Law 187 at p.188.

[24] Asante S.K.B., "The Concept of Stability of Contractual Relations in the Transnational Investment Process" in Hossain K., ed., Legal Aspects of the New International Economic Order (1980) 234 at p.259.

Another characterisation of the petroleum agreement is that they are domestic contracts. This is buttressed by U.N. resolutions on permanent sovereignty over natural resources, which imply that national laws should have primacy over the exploitation of natural resources.[26] The development of a state's natural resources must be in the interest of national development and for the benefit of the people. HCs must be able to rely on their most important resources in achieving their development goals. IOCs must be seen as willing participants in that developmental process. Thus, where at any stage a HC permits the exploitation of its resources and perceives such exploitation or the terms of the contract to be detrimental to the interests of the people, or the economy of the country it can intervene. This intervention may either take the form of termination or renegotiation of the terms so that it reflects the benefit to the people. The only contractual limitation on the HC in dealing with its natural resources is to act in accordance with the interests of its people.[27]

---

[25] Fabri has observed that the theory of 'internationalization' of the contract seems to suggest that, at least in certain regards, the proper law of a transnational contract will never be a municipal legal system but rather international law or transnational law. See supra n.3, at p.30.

[26] Supra, at pp.46-47.

[27] Walde T., "Contract Stability: Adaptation and Conflict Resolution" in U.N.D.T.C.D., Legal and Institutional Arrangements in Mineral Development (1982) 163 at p.210.

Municipal law can thus provide a mechanism for the revision of the contract through the HC. Under the permanent sovereignty principle the HC cannot therefore validly agree not to change the terms of the agreement on the exploitation of its natural resources.

It is suggested that domestic law should be the first reference point in dealing with IPAs. The adoption of rigid international concepts such as pacta sunt servanda and vested rights has been undermined by widespread practice of review and renegotiation.[28] It should be noted that the economic reality of scaring away foreign investment and international law rules against expropriation are sufficient indicators to prevent high handed action by the HC.

It will be argued in the next section that the sovereign powers of the HC can be exercised through legislation to modify or renegotiate the IPA depite the insertion of stabilization clauses.

3.1. Stabilization Provisions:

As noted, in the desire of IOCs to protect their investments against changes in the HC's legislation or rules, stabilization clauses are sometimes provided for. Under the stabilization clause, the HC undertakes not to alter or modify its legislation or rules so as to adversely affect the contractual rights or benefits of the IOC. These clauses thus reinforce the sanctity of contracts in its widest extent.

Stabilization clauses can be categorised according to the contractual or legal aspects of the regime to which they relate. They may relate to property rights, the fiscal regime, import and export regulations, foreign exchange regulations, the whole range of legal norms applying to the project, and the project regime as a whole.[29]

---

[28] See U.N.C.T.C., Transnational Corporations in World Development: a Re-examination (1978) at pp.114-120.

Having broadly grouped the various matters that these clauses cover, we shall now look at a few examples of how they are used under the IPA. A starting point is the Joint Structure Agreement between the National Iranian Oil Company and Atlantic Refining Company, Murphy Oil, Sun Oil and Union Oil of 1964. Article 37(3) of this agreement provides: "[m]easures of any nature to annul, amend or modify the provisions of this Agreement shall only be made possible by the mutual consent of both Parties".[30] A similar clause is found in Article 29 of a model Tunisian Agreement between ETAP and Private Companies. This states that "[t]he provisions of the present [c]ontract cannot be amended except through an additional clause agreed upon between the parties".[31] These clauses state quite explicitly that modification or change in the terms of the agreement cannot be done by the HC, except in circumstances where both parties agree to the change.

The common theme running through all these clauses is to "tie the hands" of the HC in making changes in the legal regime of such agreements. An example of this is the Operating Agreement of 1971 between the Islamic Republic of Mauritania and Texaco. Article 4 of this agreement, entitled stabilization conditions, states:

> "4.1. The Government guarantees the Company, for the term of this agreement, the permanence of the general, legal, economic, financial, and tax conditions under which the Company shall carry on its activities, as

---

[29] For a discussion of stabilization clauses in relation to each of these categories, see for example, Bartels M., Contractual Adaptation and Conflict Resolution (1985) at Chap.2.

[30] Basic Oil Laws and Concession Contracts - Middle East (Original Texts) Supplement No.VI (6) at p.31.

[31] Basic Oil Laws and Concession Contracts (North Africa) (1986) Supplement No.LXXIV (74) at p.84.

> those conditions are defined in the legislation and regulations in force on the date of signing of this Agreement, as well as the provisions hereof.
> 4.2. The mining legislation to be retained throughout the duration of this Agreement is listed in the appendix hereto which forms an integral part hereof.
> 4.3. It is stipulated that the guarantees granted the Company will be retained by it whatever the conditions established for other enterprises carrying on identical activities.
> 4.3. The Government is bound for the term of this Agreement not to initiate nor order any measure with respect to the Company that directly or indirectly involves an unfavourable change in the legislation and regulations in force on the date of this Agreement under the legislation and regulations governing corporations, notably with regard to the organization, operation, dissolution and liquidation of corporations, rights and conditions of transfer of shares and, in general, all of the relations between companies and stockholders".[32]

The contractual provisions quoted above fetter future legislative or administrative action by the HC, to the extent that the taking of any such action interferes with the status or operations of the IOC. The last example quoted is referred to as a "frozen" clause. It freezes the laws of the HC, so that in effect the law applicable to the agreement is the law of the HC as it stood at the date of the signing of the agreement.[33] The clause not only prohibits the HC from amending the laws applicable to the agreement, but it also prohibits any measures within the scope of the HC's legal powers which affect the project as whole. This kind of far reaching formulation puts the IOC in a position to demand the cancellation of measures it considers not to be in its interest.[34]

---

[32] Basic Oil Laws and Concession Contracts (South and Central Africa) Supplement No. XXVII (27) at p.C-3.

[33] Some provisions remove the relationship either in whole or in part from the domestic law and subject it to rules of international law - the implications of this will be discussed in the next section. Other clauses provide that in the event of a change in the HC's laws which affect substantially the economic benefits accruing to one of the parties, the contractual terms will be adjusted accordingly.

[34] Supra n.29, at p.21.

The relevant question in assessing the effectiveness of stabilisation clauses is whether they really guarantee the stability of the venture? Not surprisingly, HCs have reacted unfavourably to them, for they see such clauses as inconsistent with their sovereignty. Roland Brown refers to this situation as an attempt by the foreign private investor to create an "extra territorial or enclave status by contract",[35] and comments that it has not to a great extent, guaranteed stability for the investor. Instead, stabilization clauses have "acquired a separate life of their own as a fruitful source of provocation and misunderstanding".[36]

The main legal issue arising from stabilization provisions concerns the extent to which they can prevent the HC from unilaterally introducing changes to the law. It is uncertain to what extent the HC may undertake an obligation restricting its sovereign power of legislation. According to El-Kosheri and Riad, the legality of stabilization clauses can only be established on the basis of a public law rule authorizing the HC to include such clauses in the contract and to be bound by it. Its enforceability depends on the assumption that the HC is granting within its public powers certain legislative immunity to the contracting party. They conclude that the power to freeze the applicable rules is not only a prerogative of a public authority, but that the clause must also be subject to certain limits since it cannot be absolute.[37] In English law and countries whose legal system is patterned along the same lines, the effect of a stabilization clause would be that contract will always be subject to future legislation. The government cannot by a contractual term exclude the operation of a future statute.[38] In the case of Czarnikow Ltd. v. Centrala Handlu Zagranicznego Rolimpex, the English Court of Appeal (per Lord Denning) reiterating this principle, said:

---

[35] Brown R., "The Relationship between the State and the Multi national Corporation in the Exploitation of Resources" (1984) 33 International and Comparative Law Quarterly 218 at p.222.

[36] Id., at p.223.

[37] El-Kosheri A.S.,& Riad T.F.,supra n.16, at p.266.

> "......a government cannot fetter its duty to act for the public good. It cannot bind itself - by an implication in the contract - not to perform its public duties".[39]

Thus it could be argued that the insertion of a stabilization clause in the IPA may be of no effect where the government acts by varying the terms of a contract.[40] It is doubtful that its action be seen to be an unlawful breach of contract. It is submitted that if the HC changes the law contrary to the stabilization clause, that could be characterised as a lawful action which amounts to an expropriation in international law of contractual rights triggering the measure of compensation to be paid to the IOC.[41]

---

[38] Bowett W.D., "State Contracts with Aliens: Contemporary developments on compensation for termination or breach" (1988) LVIX The British Yearbook of International Law 50 at p.58. Bowett, acknowledges that the idea that the assertion of governmental power to vary contracts with foreigners is basically a policy favoured by developing countries is untenable. The advanced countries of the West also favour this policy, especially in the area of petroleum agreements. He cites two English writers supporting this view, who have stated that:"It will have become clearer to oil companies that the UK and Norwegian Governments are no more willing than their OPEC counterparts to stick rigidly to contracts that they deem unreasonably disadvantageous and that there is no absolute constitutional protection in either country for the principle of pacta sunt servanda". Daintith T., & Gault I., "Pacta Sunt Servanda and the Licensing and Taxation of North Sea Oil Production" (1977) 8 Cambrian Law Review 28 at p.42 quoted in id., at footnote 40.

[39] (1977) 3 Weekly Law Reports 677 at p.686.

[40] See Bowett W.D., supra n.38, at p.58. Zorn asserts that "such clauses are often found in mineral agreements, despite their ultimate legal ineffectiveness". See Zorn S.A., "New Developments in Third World Mining Agreements" (1977) 1 Natural Resources Forum 239 at p.243;

[41] See Jaenicke G., "Consequences of a Breach of an Investment Agreement Governed by International Law, by General Principles of Law or by Domestic Law of the Host State" in Foreign Investment in the Present and a New International Economic Order 177 at p.200.

It is practically not feasible for the HC to abide by a stabilization clause throughout the whole life of the project since these agreements are of a long term nature and circumstances will change during the life of the contract. Such a governmental exercise of power must not be seen as constituting obligations binding on the state. There must surely be some limits to the doctrine that a state can irrevocably bind itself through special commitments in the IPA. Sornarajah for example claims that a state can intervene in an investment agreement to terminate it or renegotiate its terms for the benefit of its people. To assert a contrary claim is to create a constitutional limitation on the state in international law to deal with the interests of its people.[42]

This principle would apply in most developing countries, irrespective of whether they follow the English legal system. Even if the state could limit its lawmaking power by contract the clause creates difficulties where there is a change of government. Experience shows that in a situation where there is a change of government - whether through a military coup d'etat or by constitutional means - new laws are promulgated and the old obligations derive their validity from the new law. On this score, the new government cannot be bound to uphold a stabilization clause that was provided for in an IPA by its predecessor government. The practical consequence of this is that HCs scarcely ever exercise such powers, because they realize the repercussions of scaring away foreign investment needed for economic development.

---

[42] See Sornarajah M., supra n.23, at p.210; See also, Note,"Petroleum Concessions in International Arbitration" (1979) Columbia Journal of International Law 259 at p.279; Brown R., "Choice of Law in Concession and Related Contracts (1976) 39 Modern Law Review 1.

It can thus be said that the HC would not be prevented by the contract from exercising its sovereign powers regarding legislation or rule-making. To assert otherwise conflicts with the fundamental concept and purpose of the permanent sovereignty of a state over its natural resources.[43] It is politically undesirable and legally unenforceable.

Stabilization clauses, to the extent that they purport to make contractual terms and the project regime as a whole immutable, are detrimental to the mutual interests of the parties. They tend to promote friction where HCs clamour for changes in the contractual regime rather than promoting the necessary stability intended by the IOC. It is inevitable that circumstances will change over the duration of a long-term contract. These clauses do not provide for review of the contract despite the changes that may have occurred in conditions. In trying to assure a reasonable balance between sovereignty and security of investment, these clauses would be wholly unnecessary if stipulations are included in the contract, providing for revision or amendment on a periodic basis or at the initiative of either party.

The next sections will show examples of clauses aimed at reaching some reasonable terms agreed between the parties. They allow change in a way that does not undermine stability. The proper formulation of these clauses will thus avert use of the state's latent power to effect changes in the contract regime.

3.2. Force Majeure Provisions:

A common principle known to all leading legal systems is that obligations assumed under a contract must be duly performed. The non-performance of contractual obligations invokes the application of sanctions against the party in default. However, supervening events beyond the control of the parties making performance impossible, or excessively burdensome, may lead to the determination of the contract, or may be a cause of excuse for non-performance on the part of the obligor.

---

[43] See De Arechaga J.E., "State Responsibility for Nationalization of Foreign owned Property" (1978) 11 New York University Journal of International Law and Politics 179 at p.192.

Force majeure provisions under the IPA vary in scope and in precision. In the same vein, acts constituting force majeure vary from one legal system to another. One would even note that domestic rules specifying what constitutes an event of force majeure in the various legal systems are riddled with inconsistencies.[44]

Under the IPA, some clauses provide for a basic definition of the term, whereas others provide a detailed definition of what acts constitute an event excusing non-performance by one of the parties. Generally, an event that constitutes force majeure must be an event which is "unforeseeable, insurmountable and not attributable to the obligor, i.e. that performance be impossible for everybody and not for the obligor only".[45] As already stated, force majeure provisions prevalent in the oil industry fall into two groups. Firstly, some clauses are incorporated into the IPA leaving the definition and scope of force majeure to be determined by a given system of law. Secondly, other clauses attempt to provide for an original definition of the concept adapted to the particular circumstances of the agreement, by specifying extensive detail of what constitutes an event of force majeure.[46] Irrespective of which of the two systems is used, the provision in most cases does not lead to termination of the agreement. Their effect is merely to suspend the obligations assumed under the contract, and to allow the resumption of performance when the events constituting the force majeure are over.

---

[44] For a brief review of what constitutes force majeure in the leading legal systems see, Delaume G.R., Law and Practice of Transnational Contracts (1988) at pp.50-53.

[45] Blinn K.W. et al., International Petroleum Exploration and Exploitation Agreements (1986) at p.285.

By way of illustration, we shall now examine how this device is used in the IPA. A starting point would be a 1980 model Partnership Agreement between Akorama (the NOC of Madagascar) and Oil Companies. The agreement specifies in Article 23 as follows:

> "23.1. No delay, default or omission of a party in the execution of any of the clauses, conditions, rights or obligations under the agreement is considered as a breach of the agreement, nor does it give the right to recourse against said party if the delay, default or omission is due to a case of force majeure and provided said party so advises the other in writing as soon as possible and take the necessary action to resume execution of the agreement in the shortest possible time.
> 23.1. The insolvency of a partner is not a case of force majeure.
> 23.3. In the sense of this agreement, cases of force majeure are comprised of any unforeseeable, irresistible events which are beyond the control of the defaulting party, such as:
> a) declared or undeclared war, civil war, riots, insurrections or any internal or external act of hostility;
> b) strikes, lock-outs, or any other labor conflict;
> c) natural calamities, particularly floods, fires, cyclones, storms, earthquakes.
> d) Acts of the State ("Faits du Prince").[47]

This clause specifies the conditions that must be satisfied before the party under obligation to perform can claim relief by way of force majeure, by making provision for written notification as soon as possible of the events. The clause goes on to outline, without defining in detail the events that comprise force majeure. One could surmise that an event which would ordinarily be regarded as constituting a force majeure, but which falls outside this definition in the event of a dispute would fall to be determined by the applicable law. By Article 25 of the agreement, the governing law is stated to be exclusively the law of Madagascar. This kind of provision falls within the first category of clauses enumerated above. These are reference clauses which Delaume refers to as "ready to wear" or "tailor made".[48] He notes that they add little to the result obtained in the absence of a stipulation. In any case, it is submitted that this approach may not be exhaustive enough in defining the scope of what is, or is not force majeure. It is however, evident that the parties in this instance must be held to contemplate that any ambiguities would be clarified, or gaps filled in by the domestic law (or whatever law is chosen to govern the relationship). As a result of the apparent confusion that exists in the different legal systems on this subject, and that was mentioned earlier, it must be asked: why do we look to an approach of this type to provide answers to this problem ? In this case, the governing domestic law, however unsettled it might be, will definitely provide an answer to the problem. It is most likely that whatever interpretation is given to the clause will be consistent with the peculiar circumstances within which the contract as a whole is to be performed. Where the domestic law is the governing law, one might add that the frequency of dealing with these problems may encourage the development of the law within that particular legal system.

---

[46] Id., at p.286.

[47] Basic Oil Laws and Concession Contracts (South and Central Africa Original Text) (1980) Supplement No.LXI (61) at p.41.

The second group of force majeure clauses is exemplified by the 1985

---

[48] Delaume G.R., "Excuse for Non-Performance and Force Majeure in Economic Development Agreements" (1971) 10 Columbia Journal of Transnational Law 242 at p.245.

Production Sharing Agreement between the Government of Tanzania and Amoco Tanzania Oil Company. Article 18 of the agreement states thus:

> "18.1. As used in this Article 18, Force Majeure means any of the following events where such event is beyond the reasonable control of the party claiming to be affected by it: war, hostilities, acts of belligerence, sabotage, insurrection, riot or disorder; expropriation, or nationalization of any equipment or assets needed to fulfil any obligations under this Agreement; embargoes or export or import restrictions, interference, restriction or onerous regulation by a legal or de facto civil or military authority, whether or not purporting to act under a constitution, law, decree or authority; natural disaster; accidents of navigation; accidents, or other uncontrollable damage to wells, pipes, storage facilities, refineries, installations, transportation facilities or distribution facilities; non availability of equipment; any rationing or allocation of any goods or reserves whether imposed by law, decree, regulation, or cooperation of industry at the insistence or request of any government authority or person purporting to act therefor, or any other event beyond the reasonable control of the party claiming to be affected by it, whether similar or dissimilar to the events listed above".[49]

It is to be observed that this clause provides for the type of events which the parties contemplate would constitute valid causes of excuse for non-performance. These are referred to as qualitative clauses. According to Delaume, their essential effect is to list.....

> ".....in a pell-mell fashion a number of events deemed to constitute valid excuses for non performance. Were it not for the much more sedate provisions which normally accompany these clauses and accurately specify the various conditions that must be met before an event listed in the clause can be considered as constituting effective impossibility to perform and the consequences of non-performance, it might be difficult to ascertain the exact intention of the parties".[50]

The Tanzanian example typifies an open-ended provision. It appears that, after categorising the events that might be considered as force majeure, the agreement goes further to include in the definition events "similar or dissimilar" to those listed. Such provisions give too wide a scope to the definition of force majeure and could give rise to difficulties in the event of a dispute.[51]

---

[49] Basic Oil Laws and Concession Contracts (Central and South Africa)(1988) Supplement No.XCV (95) at pp.60-61.

[50] Supra n.48, at p.246.

Another example of these clauses suffices to indicate the trends in the drafting of such clauses. Under a model 1988 Production Sharing contract of Gabon, Article 44 provides that:

> "44.1 No delay or default on the part of the Contractor or the State to comply with or carry out any of the provisions, conditions, rights or obligations resulting from this Contract will be considered as a violation of this Contract or confer any right upon either Party if such delay or default is due to an event of 'force majeure'. If, in the event of 'force majeure', the fulfilment of any of the provisions, conditions, rights or obligations of this Contract is postponed, the resulting delay, as well as the time necessary to repair the damages caused by or during such delay and to resume the Petroleum Operations, will be added to the duration fixed by this Contract and the exclusive exploration or exploitation Authorizations will be extended by the same period.
>
> 44.2. "Force majeure" signifies unpredictable events which are not due to any error or negligence on the part of the Parties but to circumstances beyond their control such as an earthquake, flood, accident, strike, lock-out, riot, unavoidable delay in the transportation of equipment and personnel inside or outside Gabon, delay in obtaining rights of way, prevention or hindrance in obtaining equipment or materials on the market,insurrection, civil disturbances, sabotage, acts of war or circumstances caused from war, application of any regulation, decision, ordinance, law, or any other cause beyond their control".[52]

This clause defines force majeure to be an unpredictable event which was not due to error or negligence on the part of the parties. Although the clause lists events that will constitute force majeure, the party seeking to invoke it must establish that the events constituting the force majeure are beyond their reasonable control.

---

[51] See, The Lighthouse Arbitration Case, Award of July 24/27, 1956. 12 U.N.R.I.A.A. 166 cited in id., at pp.249-250.

[52] Basic Oil Laws and Concession Contracts (South and Central Africa Original Text) (1988) Supplement No.XCIV (94) at p.82.

It is suggested that, cases of ordinary default must be distinguished from cases caused by force majeure. The conditions necessary for the occurrence of force majeure must be made less strict. There must be a variety of obligations to notify and to prove force majeure. The parties must provide for a duty to make best efforts to overcome the situation eventually by subsequent renegotiation. Finally, caution must be exercised to ensure that any such event beyond the control of the parties does not unilaterally increase the obligations of the parties beyond the contractual balance before the occurrence of the events constituting the force majeure.[53]

It is submitted that in providing for situations that sufficiently clarify what amounts to force majeure, the contract regime should easily adapt to changes in light of those events occurring without the occurence of frequent disputes.

3.3. Hardship Provisions:

Hardship clauses envisage a situation where performance of the contract has become burdensome or unduly onerous for one of the parties to the contract. Although, these clauses have hardly been used in IPAs,[54] it is worth briefly mentioning what they are, and their effect on the contract since they provide another means of dealing with unexpected changes in the contract.

The long term nature of IPAs subjects them to the risk that unforeseen circumstances may fundamentally change the contractual equilibrium. A change in circumstances may either be of an economic, technical, or political nature, or a result of environmental prescriptions, imposition of new duties on importation or exportation, or changes in monetary values or value of the commodity.[55] Typically, hardship clauses consist of two parts: firstly, they set out the events in which the clause shall be applicable; and secondly, they lay down the procedure to be adopted if any of these events occur. The hardship clause is invoked when such unexpected changes cause a fundamental alteration in the economics of the agreement. The consequences of these changes is to trigger a readjustment of the economics of the agreement so as to enable the parties to find a new equilibrium in their relationship.

---

[53] Walde T., "Revision of Transnational Investment Agreements: Contractual Flexibility in Natural Resource Development" (1978) 10 Lawyer of the Americas 265 at p.295.

[54] Supra n.44, at p.294.

The circumstances constituting hardship must not only exist but must have a particular effect on the contract.[56] Where this situation occurs the clause normally imposes a duty on the parties to renegotiate the contract. It is desirable that consequences be contained in the clause in the event of failure to reach agreement. These should take the form of arbitration, litigation or termination of the contract.

It is hoped that IPAs will increasingly make use of hardship provisions in conjunction with force majeure clauses to trigger a revision process of the economics of the agreement. The desirability of flexibility in the terms of the IPAs cannot be achieved in the absence of provisions calling for revision of the contract, in the light of hardship making it burdensome for one of the parties to discharge its obligations.[57]

---

[55] Id., at p.297.

[56] Schmitthoff C.M., "Hardship and Intervener Clauses" (1980) Journal of Business Law 82 at p.86.

3.4. Governing Law Provisions:

In this section we shall examine how the choice of law provision can be used to make the contract flexible. The discussion is viewed from the perspective that a choice of law provision subjecting the contract to municipal law makes change easy, whereas other approaches tend to create inflexibility.

The tendency in recent times is to provide for the domestic law of the HC to govern the agreement. Most developing countries now have comprehensive legislation dealing with the exploitation of their natural resources. We have already noted in Chapter 3 the legislative mechanisms in use and how these must be structured to attract the necessary foreign investment. Suffice it to say here that the policies of the HC have been embodied in such legislation and general laws which they intend should govern all agreements for the exploitation of their natural resources. Some countries have even gone further to the extent of prohibiting the possibility of any choice of law other than the domestic law of the HC in their agreements. This is done either through their constitution or through their general laws.[58]

The law governing a contract decides substantial matters about the agreement. It governs its form, validity, interpretation and execution. It is also an important issue to the resolution or avoidance of any dispute between the parties. The parties to the agreement are free to choose whatever law should govern the relationship. Where the parties indicate the choice of law in the agreement problems do not arise. The difficulties as to the applicable law do arise where the agreement is silent as to the governing law. In such instances one has to infer from the agreement what the intention of the parties are, in order to decide what law should govern the agreement. Where there is no provision or vague references to the applicable law, various theories have been propounded which give an indication that there is no settled view as to what law regulates the IPA.

---

[57] For an example of a hardship clause relating to the sale of natural gas see, supra n.45, at p.297.

[58] This phenomenon is common among the Latin American countries where the Calvo doctrine has been applied. The doctrine aims at preventing the abuse of diplomatic protection. Its rationale in this context emphasizes the exclusive jurisdiction of municipal law. It declares as unacceptable any contractual clause which provides for international arbitration or any other external procedures instead of, or in addition to the national legal system. Article 17 of the Constitution of Peru, for example, states as follows: "Commercial companies, national or foreign, are subject without restrictions, to the laws of the Republic. In every state contract with foreigners, or in the concession contracts granted in their favour, it must be expressly stated that they will submit to the laws and courts of the Republic and renounce all diplomatic claims". Quoted in supra n.43, at p.193.

As a preliminary concern, the most common forms of provision for the applicable law may be grouped under the following headings;

a) Clauses stating that domestic law of the state party applies.

b) Clauses directing the application of principles of law common to both the state party and the state(s) of the IOC.

c) Clauses providing for the application of the domestic law of the state party to one part of the agreement and international law to other parts.

d) Clauses providing for the application of international law.

As far as possible, the parties to the agreement must state clearly and in precise language what law should regulate the relationship.

We shall now briefly discuss the theories that have been propounded for either the 'internationalisation' or 'localization' of the agreement. These debates have hinged on the issue that one or the other system is the law and the other is not.[59] The importance of these theories is whether the IPA should be protected at the international or domestic law level. This has an effect on contractual changes.

a. Public International Law

It has been asserted that economic development agreements between the HC and the foreign private investor should be governed by the principles of public international law. The principal advocates of this theory have been among others, Mann, Garcia-Amador, Friedmann and Weil.[60] The argument is predicated on the assumption that the parties may choose the proper law of the contract. If international law, or other supra-national law is chosen, either expressly or by implication the contract becomes 'internationalized'.

Furthermore, according to this theory, the signing by the HC of a state contract with a foreign corporation setting legal obligations is not essentially different from the signing of a treaty since both situations set forth legal obligations.[61] In this instance, Garcia Amador and Friedmann point out that a certain degree of international personality and capacity is conferred upon the private investor.[62] This view suggests that these agreements are analogous to treaties, and like treaties would be governed by international law. The analogy between a state contract and a treaty seems to be far fetched. There is a difference between agreements between sovereign nations on one hand, and an agreement between a state and a private party which is governed by the state's municipal law. In the case of a treaty, a state cannot use its own municipal law to alter its treaty obligations towards another state. In the latter situation, the HC could assert that right and in fact they do assert such a right.[63]

---

[59] Jennings R.Y., "State Contracts in International Law" (1961) 37 British Yearbook of International Law 156 at p.179.

[60] See Kuusi J., The Host State and the Transnational Corporation - An Analysis of Legal Relationships (1979) at p.99.

[61] Ibid.

[62] Ibid.

Another reason offered for the application of international law is that some of the agreements contain provisions for the possible appointment of arbitrators by an international official. This trend, it is argued, supports the view that international law is the governing law. Although these clauses add an international dimension to the agreement, they do not necessarily result in the conclusion that the agreement has a character other than an instrument of the public and private law of the HC.[64] It should be pointed out that submission to arbitration cannot be said to be a determinative factor upon the issue of applicable law.[65]

The other factor in the general argument for application of international law is expediency. Its application circumvents the problem of the HC's unwillingness to submit to foreign law, as well as the IOC's reluctance to submit disputes to the HC's courts.[66]

b. General Principles of Law:

According to this theory, the chief proponent of which is Lord McNair, the law governing state contracts is neither to be found in rules of public international law nor in the municipal law of the HC. Private international law does not provide an answer either since, "it is adjectival and its duty is to prescribe rules for the guidance of a tribunal in deciding which system of law it should apply...".[67] He states that:

---

[63] Bowett W.D., supra n.38, at pp.45-55.

[64] Onejeme A.N., "The Law of Natural Resources Development: Agreements between Developing Countries and Foreign Investors"(1977) 5 Syracuse Journal of International Law and Commerce 1 at p.38.

[65] Delaume G.R., Transnational Contracts (1986) chap.1 at para.1.01.

[66] Jessup P., A Modern Law of Nations (1959) at p.14.

> "....the legal system appropriate to the type of contract under consideration is not public international law, but it shares with public international law a common source of recruitment and inspiration namely, the general principles of law recognized by civilized nations".[68]

For him, "general principles cannot be equivalent to international law" and he thus submits that these agreements are not "governed by international law stricto sensu,...but governed by the general principles of law recognized by civilized nations". He seeks justification for this by saying that international law cannot apply because, "this system is an inter state system -jus inter gentes".[69]

It is doubtful whether these general principles constitute a law or a legal system.[70] It is suggested that it now seems immaterial to describe such principles as a "system of law" or as a "source of law" since they have received recognition in international conventions, petroleum agreements and arbitrations.[71] The concept of a distinct body of general principles of law has gained a firm foothold by its inclusion in Article 38 of the statute of the International Court of Justice, as one of the sources of law.[72] This does not remove the uncertainties surrounding their recognition. A peculiar difficulty for example, will be the question of how many legal systems and to which legal systems must a particular principle be known before it can be classified as "general"?[73] Solutions to these questions will call for expertise in comparative law, which few judges and arbitrators have, thus revealing the danger in placing reliance on this concept.[74]

---

[67] McNair, supra n.1, at p.6.

[68] Id., at p.6.

[69] Ibid.

[70] For Mann, the general principles of law are to be considered as an extension of international law. See, Mann F.A., Further Studies in International Law (1990) at p.225.

[71] Kronfol Z.A., Protection of Foreign Investment (1972) at p.77.

Caution must be exercised as to how the general principles themselves will be interpreted. To state, for example, that "contracts are binding" would be inadequate. Bowett has stated that "it is at such a level of generality as to be misleading (since all legal systems recognize exceptions to this rule, when termination [or change] is justified) and even erroneous in that, so expressed, the maxim fails to take account of the fundamental distinction between private and public (or state) contracts".[75]

---

[72] Ibid.

[73] Supra n.64, at p.46.

[74] Id., at p.47. There have been some decisions of arbitration tribunals which have held that disputes pertaining to PAs were to be governed by general principles of law. See for example, Petroleum Development (Trucial Coast) v. Ruler of Abu Dhabi (1951) 18 International Legal Materials 144. (comparative law used as a guide to the principles that,in the circumstances are most appropriate and equitable.) ; Ruler of Qatar v. International Marine Oil Company Ltd. (1953) International Law Reports 534. (law of the HC [Islamic Law] could not be considered as the proper law since it did not contain legal principles applicable to oil concessions.); Aramco v. Saudi Arabia (1958) 27 International Law Reports 117. (in so far as there are doubts on the content of the agreement, general principles of law were resorted to in order to interpret and supplement the rights and obligations of the parties.); Sapphire Petroleum Arbitration (1963) 35 International Law Reports 136. (stipulation to carry out provisions according to the principles of good faith and goodwill and to respect spirit and letter of the agreement was not compatible with the application of municipal law. Thus general principles of law recognized by civilized nations would apply.) The reasons that one could discern from these arbitral decisions is that fact that in all of them the domestic laws of the HC were inadequate to deal with them. The relevance of such reasoning cannot apply in recent times, since laws and regulations have been enacted in HCs to deal adequately with these agreements. A resort to interpretation using general principles in the absence of express provision would seem not to be in the best interests of the HC.

[75] Bowett W.D., supra n.38, at p.55; See also the decision of the Arbitral Tribunal in Amco Asia v. Indonesia (1985) 24 International Legal Materials 1022 at p.1029 quoted in ibid.

Mann has also conceded the impossibility of stating as a general principle that a state in entering into a contract gives up the right to change its terms. However he asserts that the right and the power to do so depends on the law governing the contract. If the proper law is public international law, that power and right will necessarily be excluded. Thus, general principles of law can only be regarded as an extension of international law (since that law contains rules of a mandatory character).[76]

c. Transnational Law:

Another theory suggested for the internationalization of economic development agreements is the doctrine of transnational law. This law, it is claimed, is capable of governing situations where neither municipal law nor traditional international law would be wholly appropriate. Such situations are mainly those where in terms of traditional international law, a subject and an object of international law are involved.[77] According to Judge Jessup, transnational law includes " all law which regulates actions or events that transcend national frontiers. Both public and private international law are included, as are other rules which do not wholly fit into such standard categories".[78] Transnational law would thus seem to be a collection of rules belonging to different legal systems.[79] The rules and principles which form such a system, it is claimed, are still in their nascent stages.

---

[76] Supra n.70, at p.269.

[77] Fatouros A.A., Government Guarantees to Foreign Investors (1962) at p.284 ;See also, Lalive J.F., "Contracts between a State or State Agency and a Foreign Company" (1964) 13 International and Comparative Law Quarterly at p.987.

[78] Jessup P., Transnational Law (1956) at p.2.

[79] Abi-Saab R., "The International Law of Multinational Corporations: A critique of American Legal Doctrines" (1971) Annals of International Studies 97 at p.105.

They are drawn from a comparative survey of representative legal systems. The drafting of transnational contracts will thus seem to be providing precedents and practices which will consolidate these rules.[80]

d. Lex Contractus:

This theory, developed by Verdross, recognizes the economic development agreement as a quasi-international agreement which creates a lex contractus. In other words, the agreement is considered to be independent of any legal system and contains within it a self-sufficient system of law which exhaustively regulates the entire range of relations between the parties. The point of departure with this theory is that no contract can exist in vacuum. It must be referable to a legal system under which it is created and from which it derives its validity.

e. Municipal Law:

Advocates of the application of municipal law to economic development agreements view these contracts as legal arrangements of a purely domestic character. The HC, is presumed to enter such contracts under its own law and cannot be deemed to have submitted to any other system of law without its express consent. The fact that one of the parties to the contract is a foreign private investor does not alter the nature of the contract, so as to remove it from the jurisdiction of the HC and make it subject to another system of law.[81]

The classical theory that the law governing a state contract is the municipal law of the HC was made in the Serbian Loans Case, where the PCIJ stated:

---

[80] Fabri N., supra n.3, at p.29.

[81] Zakariya H.S., "Changed Circumstances and the Continued Validity of Mineral Development Contracts" in Hossain K. ed., supra n.24, 262 at p.264.

> "Any contract which is not a contract between States in their capacity as subjects of international law is based on the municipal law of some country".[82]

The correct interpretation of this case is that, in the absence of a specific choice of law, there is a presumption in favour of the law of the HC. Any other interpretation will violate the generally accepted view that parties to a contract are free to choose the law to govern their relationships.[83]

The conflict of law rules of most jurisdictions provide that the proper law of a contract is the legal system with which the contract has its closest connection.[84] The parties may expressly make their choice or, this may be implied. If this is not possible, the court will choose the legal system with which the contract has its closest connection.[85] In the absence of an express choice of law, there has been a suggestion that only cogent reasons would support the decision that the parties have by inference chosen a law other than the municipal law of the HC. Alternatively, it would be difficult to say that in the absence of such an implied choice the contract has its closest connection with a legal system other than that of the municipal law.[86] El-Kosheri and Riad, proceeding on the basis of private international law, have asserted that comparative law studies reveal that these rules (i.e. conflict of laws rules) are not only common to several states but also reflect principles shared by the major legal systems of the world community. According to them, "modern doctrine and case law are currently referring to general principles of conflict of laws as the appropriate source to determine the applicable law in relation to contractual relationships whether of a private law nature or characterised as public contracts".[87]

---

[82] (1929) Permanent Court of International Justice Series A No.20/21 at p.41; See also, the case of the Brazilian Loans, id., at p.121

[83] Supra n.71, at p.73.

[84] The closest connection between an economic development agreement and the HC derives from two sources; the subject-matter of the contract exists within the territory of the HC and secondly, the place of the contract is likely to be the HC in which the economic operation is to occur. See, Cherian J., supra n.1, at p.22.

[85] See for example, Cheshire & North, Private International Law (1979) at p.195.

[86] Flint D., Foreign Investment and the New International Order, in Hossain K., & Chowdhury S.R. eds., Permanent Sovereignty over Natural Resources in International Law (1984).

The other factor in the claim for the application of municipal law has been the concept of permanent sovereignty over natural resources,[88] and the general call for a new international economic order which were discussed in chapter 3. These doctrines have represented a rejection of the idea of 'internationalization' of economic development agreements. Suffice it to say here that, the claim made by developing countries bearing on these agreements is that, if national economic sovereignty is regarded as international jus cogens, contractual provisions to the contrary which tend to indicate a reference to international law, submission to non-national arbitration, and stabilization clauses will not be able to insulate the contract from the reach of municipal law.[89]

---

[87] They have also asserted that among other general principles of private international law which cover both contractual and non-contractual relationships, reference should be made to the general principles of law which prescribe the necessary applicability of mandatory rules in the territory where certain activities are conducted. The mandatory public law rules which are of a political or economic nature, they conclude is well recognised and whatever the proper law of the contract may be, "such rules may have an important influence on the rights and obligations of the contracting parties, because their application or non-application cannot possibly be left to the parties' discretion. These rules which are outside the scope of the proper law, normally originate from a domestic legal order in the exercise of national sovereignty. However, they may also stem from public international law which imposes certain rules of a jus cogens nature that may not be derogated from even by the states themselves. See El-Kosheri A.S., & Riad T.F., supra n.16, at pp.273,274.

[88] Sornarajah asserts that the central concept of permanent sovereignty over natural resources is that, municipal law is the first reference point in every dispute over resources. See Sornarajah M., supra n.23, at p.208.

Attempts at protecting the legal regime of the IPA at the international level tend to create a rigid and immutable structure which does not easily adapt to change.[90] It is suggested that subjecting the contract to municipal law will accord with notions of modification conforming to changing national needs and the protection of the investor.

4. Concluding Remarks

The relevant attention now should be directed at discerning new trends in the practice of HCs and at shaping norms that would accord with prevailing community objectives.[91] The argument based on the inadequacy of the legal systems of developing countries to deal with the complex nature of the economic development agreement cannot be entirely correct today.[92] Most developing countries have enacted comprehensive investment codes and petroleum laws which provide adequate legal protection for foreign investment. There are, for example, rules relating to the payment of compensation in the event of the contractual rights of the foreign investor being violated. These countries are thus determined to maintain a healthy investment climate which will be fair, stable and equitable. They are also aware of the fact that the provision of a suitable legal environment is a sine qua non for development.

---

[89] Walde T., "Contract Stability: Adaptation and Conflict Resolution" in supra n.27, at p.164. One may however argue that if the HC voluntarily agrees to 'internationlisation', that would prevail.

[90] Supra n.3, at p.35.

[91] Supra n.27, at p.195.

[92] See generally, I.C.S.I.D., Investment Laws of the World (1990); U.N.C.T.C., National Legislation and Regulations Relating to Transnational Corporations (1976).

Turning to the issue of choice of law, where the law of the HC does not provide an answer to a particular problem, one could look to other sources of law to 'fill in gaps', taking into account the particular circumstances, and the environment in which the agreement operates. The reference to other sources of law includes public and private international law rules, general principles of law, principles of law widely used in petroleum resources countries,[93] and transnational law. In the application of these principles, flexibility should be the cardinal aim and not a situation of "hark[ing] back to obsolescent controvers[ies] over the most general of principles".[94]

The cardinal principle to be considered in drafting contract clauses is the prudence of building into them flexibility to cope with varying conditions. A pre-designed adaptation of contractual terms to changes in circumstances is the best guarantee for the stability of the relationship. It is suggested that the United Nations Centre for Transnational Corporations could be the proper forum to start the basic 'groundwork' for ascertainment, consolidation and possibly codification of these principles. This can be done by a comprehensive study of contractual provisions (some of which we have discussed) that often tend to create friction between the parties during the term of the contract. Model clauses, for example relating to force majeure, hardship, choice of law and others can thus be drawn to serve as guides for future contracts. It should be reiterated that many case studies demonstrate few if any, petroleum contracts survive their legal regime in their original form.[95]

---

[93] These provisions have been used in model petroleum contracts in China and Oman. See Blinn K.W. et al., supra n.45, at p.308.

[94] Supra n.59, at p.181.

All aspects of the agreement dealing with changed circumstances which prevents flexibility should be taken account of in drawing these clauses. This way rigid clauses that make the contract immutable will be discouraged. It is hoped that contracts can be structured by the parties within the proposed framework laid down by the United Nations Centre on Transnational Corporations. The parties may however be cautious if they wish to incorporate any such clauses into their agreement. They must always ensure that local circumstances are given priority in each individual case. It is possible that an exercise of the sort advocated here will go a long way in meeting the legitimate demands and expectations of both parties.

---

[95] For example, out of a total of 43 petroleum contracts, only 4 with renegotiation clauses were actually renegotiated as opposed to 39 (without renegotiation clauses) which were renegotiated between the years 1974-77. See supra n.53, at p.285; See also, Mikesell R.F., Foreign Investments in Petroleum and Mineral Industries:Case Studies of Investor-Host Country Relations (1971).

CHAPTER 6

CONCLUSIONS

Important changes have occurred in the legal and economic arrangements under which petroleum development has taken place in developing countries over the past few decades. These changes are noticeable in the transition from the terms of the original concession arrangements to the new forms of contract systems in operation in the international petroleum industry today.

The most significant area of concern identified in this study deals with structuring agreements in order to provide for stability and equity in the relationships between HCs and IOCs. There are a number of factors beyond looking at the mere contractual provisions that go into structuring a good petroleum arrangement. For a HC it is necessary to undertake a broad study of the global operations of the IOCs in order to understand the workings of the oil industry. This will determine which category of companies it wants to deal with taking into account its possible reserves. Following this, a HC should determine in advance the policy objectives it wants to achieve vis-a-vis what the IOC is looking for. Once the policy goals have been identified attempts must be made to structure contractual provisions within that broad framework when it comes to negotiations. A recognition of the mutual interests of both parties can only be achieved if concessions are made without bargaining too much away from either side, since the various interests are going to be reflected in the terms of the contract.

In proposing a choice of legal framework within which meaningful development of the petroleum resources of the HC must take place a number of issues must be seriously addressed.

The fundamental concern for HCs should be the setting up of appropriate institutional and legislative mechanisms. NOCs for example, have become an expression of the policy goals of HCs and are now often required to implement those goals. Whereas their structure, operations and control may vary from one country to another, it is essential that they be given a free hand to operate. The daily operational issues should be left to the NOCs. At the same time some form of governmental control for example, setting the general priorities and guidelines is necessary to ensure that they do not become a liability on the HC.

Also, the employment of a legislative mechanism to facilitate the smooth operation of institutions and developmental goals must be taken account of. We have discussed the merits and demerits of the general legislative system, hybrid system and the agreement system . It is suggested that for a country with small to medium size reserves, the hybrid system would be a prudent choice. This system sets up fundamental guidelines and minimum conditions prior to negotiating contractual terms. The bargaining power of the HC is thus strengthened since it would have to proceed from the statutory minimum conditions set. This allows the relevant issues to be addressed by both parties to be dealt with in legislation, or in contract. Also, the added flexibility to adjust to changing circumstances makes this system commendable.

In contractual arrangements clauses providing for minimum work commitments and expenditure, periodic reports on work programs, relinquishment of portions of contract area held after a reasonable duration must be constantly monitored.

Training of nationals, technology transfer and environmental concerns, the rate of return on any development and share of petroleum produced, duration of the contract, amongst others, must be formulated in the context of objectives sought to be achieved by each country.

Reinforcement of control over petroleum operations by participating directly in management and at other levels of the operation is important. The respective roles of the IOC and HC as to management and control of operations must be clearly formulated to avoid duplication of roles. The 1976 Indonesian production sharing contract offers a typical example of the confusion that can result from lack of a clear sharing of responsibilities. A minimum state participation of say 50% seems desirable, and higher levels of participation can be tied to higher production levels. Different participation levels will have the effect of enabling nationals of HCs gain a detailed knowledge of the workings of different aspects of the oil industry. In the long-run this will achieve for HCs less dependence on the IOCs for the development of their oil resources.

The shift from a fiscal regime of flat royalties to graduated income taxes, as well as the application of the resources rent tax is indeed encouraging. An efficient tax regime must allow the HC to capture the desired portion of economic rent whilst at the same time preventing a reduction of the IOCs' incentives to explore for and develop the oil resources of the HC. This efficiency can be measured by tax rates which increase with oilfield profitability. The Abu Dhabi experience of providing for different income tax rates which depend upon the size of the oilfield and its profitability is worthy of emulation.

Having noted the importance of tailoring provisions to the needs and objectives of the parties, the significance of the different types of contract forms used in the industry must be viewed from the perspective of opportunities which they open up for the accommodation and realisation of the HCs and IOCs goals. The realisation of goals will not depend on the type of contract, but will be expected to be based on the substance of the contractual provisions negotiated. Thus a combination of various terms can be brought together in one package to yield the desired results.

As regards the stability of contracts, IOCs have stressed the sanctity of contracts or the doctrine of pacta sunt servanda as the overriding principle governing investment agreements between them and HCs. We have noted how this doctrine has been developed to guarantee protection for the IOC. The stabilization clause contained in the agreement between Mauritania and Texaco for example, binds the government for the term of the contract not to initiate any measure involving change in the legislation and regulations in force on the date of the agreement. The inclusion of clauses providing for application of laws other than those of the HC in investment agreements offer a further example of the application of this doctrine. HCs on the other hand, have argued on the basis of their supreme sovereign power, the various United Nations Resolutions on permanent sovereignty over natural resources, and the call for a new international economic order, that they have the right to change unilaterally the terms and conditions of the agreement in the light of changing circumstances (i.e. the principle of rebus sic stantibus).

It has been suggested that if the agreement is subject to the municipal law of the HC, then international law principles cannot be applied. The issue of renegotiation thus lies within the jurisdiction of the HC's legal system. International law would be relevant only to determine the right to and the measure of compensation to be paid to the IOC if the changes in the contractual regime amounted to creeping nationalization.[1] The attempts at 'internationalisation' and the construction of an 'international law of contracts', based as they are, on a handful of arbitral awards is somewhat fragile.[2] Pitched against this, on the other hand, the set of norms contained in the declarations on permanent sovereignty over natural resources and the call for a new international economic order offer a formidable array of principles that cannot be ignored. The development of a state's natural resources must be in the interest of national development and for the benefit of the people. The exploitation of these resources is to be governed by the HCs national legislation. U.N. Resolution 1803 makes it quite explicit that care is to be taken to ensure that there is no impairment for any reason on the exercise of a state's sovereignty over its natural resources.

The new regime being sought for international petroleum agreements cannot be based on the previous situation where IOCs seek to achieve long term stability through guarantees that often had the effect of making the agreement unstable in the long run. To fashion an appropriate body of law based on "general principles of law" and on international practice, the relevant inquiry must be directed at the principles applicable in fact to state contracts in national law, and the abundant recent experience with nationalizations and other types of interference with state contracts.[3] The aim of this inquiry is to formulate compromise positions that will ensure the freedom of action of HCs as well as a minimum standard of protection for the IOCs, and for that matter, foreign investment in developing countries generally. As suggested earlier, the United Nations Centre for Transnational Corporations should be the appropriate forum for ascertaining and codification of these principles which in the long run should serve as models within the framework of which future contracts can be structured.

---

[1] Walde T., "Revision of Transnational Investment Agreements: Contractual flexibility in Natural Resources Development" (1978) 10 Lawyer of the Americas 265 at p.270.

[2] Fatourous for example, notes that 'internationalisation' of the contract resolves nothing by itself. It provides no generally accepted answers to the quest for the legal rules applicable. See Fatourous A.A., "International Law and the Internationalized Contract" (1980) 74 American Journal of International Law 134 at p.136.

In sum, contractual provisions which allow for renegotiation, periodic revision, adjustment in light of changing circumstances will be expected to introduce flexibility and progressivity in the contractual regime for oil development. This way an equitable and stable regime will be ensured. As one writer has rightly pointed out:

> "The signal of a new era may have evolved; Governments are trying to agree on a proper role for the oil companies while the oil companies are increasingly being recognised as legitimate agents of development provided they act in accordance with the development objectives of the countries in which they operate and show greater sensitivity to the needs and concerns of these countries. The international community is ready to assume the task of watching to see that the roles are being played properly, according to the new rules of the game...."[4]

The new rules of the game will be based on a renewed commitment by HCs to refrain from arbitrarily changing the terms and conditions of the contracts entered into. The contracts must guarantee the prospect of a sufficient return on investment to the IOC should exploration prove successful. For the HCs this should mean that the exploitation of their oil resources benefits their economies. There must be some general understanding of how revenue generated by the successful undertaking is to be divided between the HCs and IOCs. It has also been suggested that the introduction of some procedure, possibly involving participation of a respected international institution will ensure that international petroleum agreements are equitable as between the parties.[5] It is hoped that a new generation of international petroleum agreements will emerge which will satisfy the demands of HCs as owners of a non-renewable resource, whilst at the same time meeting the requirements of the IOCs.

---

[3] Id., at p.137.

[4] Emphasis added. See Wilson R., "Oil Companies and the challenge of Law in their arrangements for Petroleum Development" (1984) 3 Oil and Gas Law and Taxation Review 235 at p.328.

---

[5] See generally, Faber M., & Brown R., Changing the Rules of the Game (A Commonwealth Secretariat Internal Paper).

BIBLIOGRAPHY

BOOKS

Adelman M.A., The World Petroleum Market (1972).

Ajami R.A., Arab Response to the Multinationals (1979).

AL-Qasem A., Principles of Petroleum Legislation -The Case of a Developing Country (1985).

Arsanjani M.H., International Regulation of Internal Resources (1981).

Annel L.,.& Nygren B., The Developing Countries and the World Economic Order (1980).

Arsanjani M.H., International Regulation of Internal Resources (1981).

Barrows Company Inc., World Petroleum Arrangements (1982).

Barrows G.H., International Petroleum Industry (1968).

Barrows G.H., Worldwide Concession Contracts and Petroleum Legislation (1983).

Bartels M., Contractual Adaptation and Conflict Resolution (1985).

Bartlett A.G., Barton R.J., Bartlett J.C., et al., Pertamina - Indonesian National Oil (1972).

Basic Oil Laws and Concession Contracts - Asia and Australasia (Original Texts) Supplement No. L11 (52).

Basic Oil Laws and Concession Contracts - South and Central Africa (Original Texts) Supplement No. LXI (61).

Basic Oil Laws and Concession Contracts - Central America and Caribbean (Original Texts). Supplement No.72.

Basic Oil Laws and Concession Contracts - South and Central Africa (Original Texts). Supplement No.XCI (91).

Basic Oil Laws and Concession Contracts - Middle East (Original Texts). Vol.2.

Basic Oil Laws and Concession Contracts - South and Central Africa (Original

Texts). Supplement No.LXXVI (76).

Basic Oil Laws and Concession Contracts - North Africa (Original Texts). Supplement No.LXXIV (74).

Basic Oil Laws and Concession Contracts - Middle East (Original Text). Supplement No. XCIII (93).

Blair J.M., The Control of Oil (1976).

Blinn K.W., Duval C., Le Leuch H., et al., International Petroleum Exploration. Exploitation Agreements - Legal, Economic & Policy Aspects (1986).

Brossard E.B., Petroleum - Politics and Power (1983).

Cameron P.D., Property Rights and Sovereign Rights: The Case of North Sea Oil (1983).

Canadian Institute of Resources Law, Alternative Management Regimes for Oil and Gas Activities Onshore in the Yukon and in the Beaufort Sea (1989)[Unpublished].

Carlson S., Indonesia's Oil (1977).

Cattan H., The Law of Oil Concessions in the Middle East and North Africa (1967).

Cattan H., The Evolution of Oil Concessions in the Middle East and North Africa (1967).

Cherian J., Investment Contracts and Arbitration (1975).

Clark S.J., The Oil Century (1958).

Conrad R.F., & Hool Bryce R., Taxation of Mineral Resources (1980).

Curzon G.N., Persia and the Persian Question(1892).

Dam K.W., Oil Resources - Who Gets What How ? (1976).

Delaume G.R., Law and Practice of Transnational Contracts (1988).

Delaume G.R., Transnational Contracts (1986).

El-Salafy A.M., The Nature of the Arab Oil Industry: An Historical Perspective(1974).

Elian G., The Principle of Permanent Sovereignty over Natural Resources (1979).

Engler R., The Politics of Oil (1961).

Fabrikant R., Legal Aspects of Production Sharing Contracts in the Indonesian Petroleum Industry (1973).

Fatouros A.A., Government Guarantees to Foreign Investors (1962).

Fatouros A.A., Legal Guarantees to Foreign Investors (1952).

Financial Times Oil and Gas International Yearbook (1982).

Ghadar F., Petroleum Investment in Developing Countries (1982).

Ghanem S., OPEC- The Rise and Fall of an Exclusive Club (1986).

Greene W.N., Strategies of the Major Oil Companies (1985).

Gupta R.N., Oil in the Modern World (Reprint edition 1976).

Harvard Business School Papers, Oil's First Century (1959).

Hogg P.W., Liability of the Crown (1971).

Hossain K., Law and Policy in Petroleum Development (1979).

Hossain K. ed., Legal Aspects of the New International Economic Order (1980).

Ijalaye D.A., The Extension of Corporate Personality in International Law (1978).

International Petroleum Encyclopedia (1988).

Jacoby N.H., Multinational Oil(1974).

Jessup P., Transnational Law (1956).

Kemp A., Petroleum Rent Collection Around the World (1987).

Kronfol Z.A., Protection of Foreign Investment (1972).

Kuusi J., The Host State and the Transnational Corporation - An Analysis of Legal Relationships (1979).

Lax H.L., Political Risk in the International Oil and Gas Industry (1983).

Lax H.L., States and Companies - Political Risks in the International Oil Industry (1988).

Laxer J., Canada's Energy Crisis (1975).

League of Nations., Official Journal, 13th Year(1932).

Longrigg S.H., Oil in the Middle East; Its Discovery and Development(1968).

Madelin H., Oil and Politics (1957).

Makarczyk J., Principles of A New International Economic Order (1988).

Mclean J.G. & Haigh R.W., The Growth of Integrated Oil Companies (1954).

Meagher R.F., An International Redistribution of Wealth and Power - A Study of the Charter of Economic Rights and Duties of States (1979).

Megateli A., Investment Policies of National Oil Companies(1980).

Mikdashi Z., A Financial Analysis of Middle Eastern Oil Concessions:1901-65 (1966).

Mikdashi Z., The Community of Oil Exporting Countries(1972).

Mikesell R., Foreign Investment in the Mineral and Petroleum Industries (1971).

Mikesell R.F., Petroleum Company Operations and Agreements in the Developing Countries(1984).

Mughraby M.A., Permanent Sovereignty over Oil Resources (1965).

Myrdal G., Economic Nationalism and Internationalism (1957).

National Petroleum Council, Third World Petroleum Development: A Statement of Principles (1982).

Odell P., & Smart I., The Political Implications of North Sea Oil and Gas (1975).

Odell P., Oil and World Power (7th ed) (1983).

Odell P.R., & Rosing K.E., Optimal Development of the North Sea's OilFields - A Study in Divergent Government and Company Interests and their Reconciliation (1976).

OPEC, Official Resolutions and Press Releases 1960-1983(1984).

Penrose E.T., The Large International Firm in Developing Countries: The International Petroleum Industry (1968).

Rochmat R., Contractual Arrangements in Oil and Gas Mining Enterprises in Indonesia (1981).

Rouhani F.A., A History of O.P.E.C. (1971).

Sampson A., The Seven Sisters: The Great Oil Companies and the World they Shaped (1975).

Schurr S.H, Homan P.T et al., Middle Eastern Oil and the Western World: Prospects and Problems (1971).

Shawdran B., The Middle East Oil and the Great Powers(1985).

Smith D., & Wells L., Negotiating Third World Mineral Agreements (1975).

Stevens P.J., Joint Ventures in Middle East Oil (1976).

Stockholm International Peace Research Institute,Oil and Security (1974).

Stocking G.W., Middle East Oil (1970).

Tanzer M., & Zorn S., Energy Update (1985).

Tanzer M., The Political Economy of International Oil and the Underdeveloped Countries (1969).

Toriguian S., Legal Aspects of Oil Concessions in the Middle East (1972).

Turpin C., Government Contracts (1972).

U.N.C.T.C., Alternative Arrangements for Petroleum Development (1983).

U.N.C.T.C., Financial and Fiscal Aspects of Petroleum Exploitation (1987).

U.N.C.T.C., Main Features and Trends in Petroleum and Mining Agreements (1983).

U.N.C.T.C., Transnational Corporations in World Development - Trends and Prospects (1988).

Waddams F.C, The Libyan Oil Industry (1980).

CASES

Anglo-Iranian Oil Case (1923) Permanent Court of International Justice, Series A, No.1.

Amco Asia v. Indonesia (1985) 24 International Legal Materials 1022.

Aramco v. Saudi Arabia (1958) 27 International Law Reports 117.

Czarnikow Ltd. v. Centrala Handlu Zagranicznego Rolimpex (1977) 3 Weekly Law Reports 677.

Petroleum Development (Trucial Coast) v. Ruler of Abu Dhabi (1951) 18 International Legal Materials 144.

Ruler of Qatar v. International Marine Oil Company Ltd. (1953) International Law Reports 534.

Sapphire International Petroleum Limited v. NIOC (1967) 35 International Law Reports 136.

Saudi Arabia v. Arabian American Oil Company (1958)) 27 International law Reports 117.

Serbian Loans Case (1929) Permanent Court of International Justice, Series A, No.20/21, 41.

Tamlin v. Hannaford [1950] 1 Kings Bench 18.

Texaco v. Government of the Libyan Arab Republic, (1979) 53 International Law Reports 389.

United States v. Standard Oil 221 U.S. (1910) 1.

UNITED NATIONS DOCUMENTS

Res. 1314 (XIII), 12 December 1958.

Res. 523 (VI), February 12 1952.

Res. 2386 (XXIII), 19 November 1968.

Res. 2629 (XXV), 11 December,1970.

Res. 3016 (XXVII), 18 December 1972.

Res. 3171 (XXVIII), 17 December 1973.

Res. 3201 (S -VI), 1974.

Res. 3202 (S-VI0), 1974.

UNCTAD 1, Proceedings of the United Nations Conference on Trade and Development, U.N.Doc. TD/180, Vol.1 (1972).

UNCTAD Res.45 (111), 18 May 1972.

LEGISLATION

Canada Petroleum Resources Act, 1986.

Ghana National Petroleum Law, 1983 (P.N.D.C.L. 64).

Ghana National Energy Board Law, 1983 (P.N.D.C.L 62).

Ghana Petroleum (Exploration and Production) Law, 1984.

ARTICLES

Abi-Saab R., "The International Law of Multinational Corporations: A critique of American Legal Doctrines" (1971) Annals of International Studies 97.

Adede A.O., "A Profile of Trends in the State Contracts for Natural Resources between African Countries and Foreign Companies"(1980) 12 New York University Journal of International Law and Politics 423.

Al-Ani T.F., "Viewpoint on the Service Contract for Exploration, Exploitation and Marketing of Oil" (1977) 1 No.4 OPEC Review 32.
Alleyne D.H., "Financial Provisions of State Petroleum Enterprises in Developing Countries" in U.N. ed., State Petroleum Enterprises in Developing Countries (1980) 151.

An T., "The Law Applicable to a Transnational Economic Development Contract" (1987) 21 Journal of World Trade Law 95.

Asante S., & Stockmayer A., "Evolution of Development Contracts, the Issue of Effective Control" in Legal and Institutional Arrangements in Mineral Development (1982).

Asante S.K.B., "Restructuring Transnational Mineral Agreements" (1979) 73 American Journal of International Law 335.

Banerjee S.K., "The Concept of Permanent Sovereignty over Natural Resources - An Analysis" (1968) 8 Indian Journal of International Law 515.

Barraz P., "The Legal Status of Oil Concessions" (1971) Journal of World Trade Law 109.

Bell J., "National Oil Companies:Quo Vadis? The need for National Oil Companies and their relationship to Government and Industry"(1981) 1 Energy Law 31.

Blitzer C.R. et al., "Oil Exploration in the Developing Countries: Poor Geology or Poor Contracts?" (1985) 9 No.4 Natural Resources Forum 293.

Bowett W.D., "State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach" (1988) LVIX The British Yearbook of International Law 50.

Broadman H.G., "Incentives and Constraints on Exploratory Drilling for Petroleum in Developing Countries" (1985) 10 Annual Review of Energy 217.

Broadman H.G., & Dunkerly J., " The Drilling Gap in Non-OPEC Developing Countries:The Role of Contractual and Fiscal Arrangements"(1985) 25 No.3 Natural Resources Journal 415.

Brown R., "The New Petroleum Code in Tanzania - Policy Options for Exploration in a Developing Country" (1981) 1 Energy Law 341.

Brown R., "The Relationship between the State and the Multi national Corporation in the exploitation of Resources" (1984) 33 International and Comparative Law Quarterly 218.

Carden L.J., "Taxation - Resources Taxes, Royalties and other Taxes peculiar to the Mining Industry" (1977-78) 1 Australian Mining and Petroleum Law Journal 491.

Charalambos C., "State Petroleum Enterprises in Developing Countries" (1978) 3 Natural Resources Forum 73.

Daintith T., & Gault I., "Pacta Sunt Servanda and the Licensing and Taxation of North Sea Oil Production" (1977) 8 Cambrian Law Review 28.

Date-Bah S.K., "The Legal Regime of Transnational Investment Agreements that is most compatible with both the encouragement of foreign investors and the achievement of the legitimate national goals of Host States"(1971) 15 Journal of African Law 241.

Date-Bah S.K.,"The Contract as a Mechanism for Taxation" (1988) 6 Journal of Energy and Natural Resources Law 41.

De Arechaga J.E., "State Responsibility for Nationalization of Foreign Owned Property" (1978) 11 New York University Journal of International Law and Politics 179.

Dehua Y.,"Incentive Policy and Measures Adopted in China on Offshore Petroleum Exploration and Development on the Basis of Mutual Benefit"(1988) Energy Law 793.

Delaume G.R., "Excuse for Non-Performance and Force Majeure in Economic Development Agreements" (1971) 10 Columbia Journal of Transnational Law 242.

El-Kosheri A.S., & Riad T.F., "The Law Governing a New Generation of Petroleum Agreements: Changes in the Arbitration Process" (1986/87) ICSID Review - Foreign Investment Law Journal 260.

Ely N., "Changing Concepts of the World's Mineral Development Laws" in Proceedings of the International Bar Association Seminar on World Energy Laws, Norway, May 1975, 28.

Emerson C., "Taxing Natural Resource Projects" (1981) Natural Resources Forum 124.

Evan H.Z., "The Multinational Oil Company and the Nation State" (1970) 4 Journal of World Trade Law 666.

Faber M., "Some Old and New devices in Mineral Royalties and Taxation" in Legal and Institutional Arrangements in Minerals Development (1982).

Faber M., & Brown R., Changing the Rules of the Game (A Commonwealth Secretariat Internal Paper 1979).

Fabri N., "The Legal Nature of Petroleum Agreements: A Comparative Analysis" (1986) Australian Mining and Petroleum Law Association Yearbook 1.

Fabrikant R., "Production Sharing Contracts in the Indonesian Petroleum Industry" (1975) 16 Harvard International Law Journal 303.

Farer T.J., "Economic Development Agreements:A Functional Analysis" (1971) 10 Columbia Journal of International Law 200.

Fatourous A.A., "International Law and the Internationalized Contract" (1980) 74 American Journal of International Law 134.

Flint D., Foreign Investment and the New International Order in Hossain K., & Chowdhury S.R. eds., Permanent Sovereignty over Natural Resources in International Law (1984).

Franko L.G., "Arab Countries and Western Oil Companies: Is Co-operation Possible?" Paper read at the Seminar on Administration of the Oil Resources of Arab Countries, Tripoli, (April 1974) 4.

Friedmann W., " A Theory of Public Industrial Enterprise", in Hansen A.H. ed., Public Enterprise - A Study of its Organization and Management in Various Countries (1980) 151.

Garnaut R.G., & Clunies Ross A.I., "Uncertainty, Risk Aversion and the Taxing of Natural Resource Projects"(1975) 85 Economic Journal 272.

Geigher R., "The Unilateral Change of Economic Development Arrangements" (1974) 23 International and Comparative Law Quarterly 73.

Gess K.N., "Permanent Sovereignty Over Natural Resources " 13 International and Comparative Law Quarterly 398.

Ghadar F., "Political Risk and the Erosion of Control: the Case of the Oil Industry" in Khan K.I.F. ed., Petroleum Resources and Development - Economic Legal and Policy Issues for Developing Countries (1987) 108.

Gillis M.,"Evolution of Natural Resources Taxation in Developing Countries"(1982) 22 Natural Resources Journal 620.

Girvan N., "Economic Nationalism" in Vernon R., The Oil Crisis (1976).

Griffith J.A.G., "Public Corporations as Crown Servants" (1952) 9 University of Toronto Law Journal 169.

Halbouty M.T., "World Petroleum Reserves and Resources with Special Reference to Developing Countries" in U.N., Petroleum Exploration Strategies in Developing Countries (1982) 3.

Hoyt M.P., "Overview:Increasing Exploration Incentives in International Petroleum Agreements" in Proceedings of the International Bar Association, Energy Law '88 747.

Hyde J.N., "Permanent Sovereignty Over Natural Wealth and Resources"(1956) 50 American Journal of International Law 854.

Jennings R.Y., "State Contracts in International Law" (1961) 37 British Yearbook of International Law 156.

Kemper R., "The Concept of Permanent Sovereignty and its Impact on Mineral Contracts" in Legal and Institutional Arrangements in Mineral Development (1982).

Khan K.I.F., "Petroleum Taxation and Contracts in the Third World - A Law and Policy Perspective" (1988) 22 Journal of World Trade 67.

Khan K.I.F, "National Oil Companies: form,structure,accountability and control" in Petroleum Resources and Development (1987) 185.

Kinna J.C., "Investing in Developing Countries: Minimisation of Political Risk" (1983) 1 Journal of Energy and Resources Law 89.

Kuehne G., "Responsiveness and Security within Resource Regimes" (1988) Energy Law 319.

Lalive J.F., "Contracts between a State or State Agency and a Foreign Company" (1964) 13 International and Comparative Law Quarterly 987.

Le Leuch H., "Recent Evolution of Petroleum Exploration and Exploitation Agreements in Developing Countries: New Approaches to Introduce more Flexibility and Progressivity in the Contracual Terms" (1986) Natural Resources Forum 205.

Lenczowski G., "The Oil Producing Countries" in Vernon R, ed., The Oil Crisis (1976) 59.

Mann F.A., "Another Agreement between States under National Law" (1974) 68 American Journal of International Law 490.

Mann F.A., "The Theoretical Approach towards the Law Governing Contracts between States and Private Foreign Persons" in Further Studies in International Law (1990).

Mann F.A., "The Proper Law of Contracts Concluded by International Persons" in Studies in International Law (1973) 222.

McCall J.K., "Legal Aspects of Doing Business with National Oil Companies" in International Bar Association, ed., Energy Law in Asia and the Pacific (1982).

McNair A.D., "The General Principles of Law Recognized by Civilized Nations" (1957) 33 British Yearbook of International Law 1.

Mikesell R.F., "Profitability and Risk in Third World Petroleum: the Host Government Perspective" in Khan K. ed., Petroleum Resources and Development (1987) 156.

Moorthy V.K., "The Malaysian National Oil Corporation - Is it a Government Instrumentality" (1981) 30 International and Comparative Law Quarterly 638.

Moquet A., "Problems Related to the Negotiation of Production-Sharing Contracts" (1988) Energy Law 762.

Moran T., "The Evolution of Concession Agreements in Underdeveloped Countries and the U.S. National Interest" (1974) 7 Vanderbilt Journal of Transnational Law 315.

Nicolazzi M., "Petroleum Law and Petroleum Joint Ventures in Italy" (1980) 8 Journal of Energy and Natural Resources Law 30.

Note, "Petroleum Concessions in International Arbitration", (1979) Columbia Journal of International Law 259.

O'Keefe P.J., "The United Nations and Permanent Sovereignty Over Natural Resources" (1974) 8 Journal of World Trade Law 239.

Olorunfemi M.S., "Managing Nigeria's Petroleum Resources"(1986) OPEC Bulletin 24.

Onejeme A.N., The Law of Natural Resources Development: Agreements between Developing Countries and Foreign Investors"(1977) 5 Syracuse Journal of International Law and Commerce 1.

Penrose E.T., "The Structure of the International Oil Industry: Multinationals, Governments and OPEC" in Rees J., & Odell P., eds., The International Oil Industry (1987) 13.

Schmitthoff C.M., "Hardship and Intervener Clauses" (1980) Journal of Business Law 82.

Schwebel S.M., "International Protection of Contractual Arrangements" (1959) Proceedings of the American Society of International Law 268.

Smith D., "Mining the Resources of the Third World: From Concession Agreements to Service Contracts" (1973) 67 American Journal of International Law 227.

Smith E.N., & Dziekowski J.S., "A Fifty-Year Perspective on World Petroleum Arrangements" (1989) 24 Texas International Law Journal 13.

Sornarajah M., "The Myth of International Contract Law" (1982) 16 Journal of World Trade Law 187.

Suleiman A., "The Oil Experience of the United Arab Emirates and its Legal Framework" (1988) 6 Journal of Energy and Natural Resources Law 1.

Suratgar D., "Considerations Affecting Choice of Law Clauses in Contracts between Governments and Foreign Nationals" (1962) 2 Indian Journal of International Law 273.

Tanzer M., "Negotiation Strategies and Objectives in Petroleum Exploration and Development Agreements" in United Nations, Petroleum Exploration Strategies in Developing Countries (1982) 216.

Verdross A., "Quasi-International Agreements and International Economic Transactions" (1964) The Yearbook of World Affairs 230.

Walde T., "Revision of Transnational Investment Agreements: Contractual Flexibility in Natural Resources Development" (1978) 10 Lawyer of the Americas 265.

Walde T., "The Role of Government in Mineral Development: Mining Legislation and Mineral Development Agreements" (1984) International Energy Law 1161.

Walde T., "Contract Stability: Adaptation and Conflict Resolution", in U.N.D.T.C.D., Legal and Institutional Arrangements in Mineral Development (1982) 163.

Walde T., "Lifting the Veil from Transnational Mineral Contracts: A Review of Recent Literature" (1977) 1 Natural Resources Forum 277.

Wilson R., "Oil Companies and the Challenge of Law in their Arrangements for Petroleum Development" (1984) 3 Oil and Gas Law and Taxation Review 235.

Zakariya H.S., "Changed Circumstances and the Continued Validity of Mineral Development Contracts" in Hossain K., ed., Legal Aspects of the New International Economic Order (1980) 262.

Zakariya H.S., "State Petroleum Companies" (1978) 12 Journal of World Trade Law 481.